A PRIMER OF FOREIGN EXCHANGE

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THIRD IMPRESSION

LONDON: SIR ISAAC PITMAN & SONS, LTD.
BATH, MELBOURNE, TORONTO AND NEW YORK

First Impression *May,* 1919.
Second ,, *August,* 1919.
Third ,, *July,* 1920.

PREFACE

THIS little book has grown out of many a pleasant chat on Foreign Exchange with theorists, practical exchange men, bankers, brokers, teachers, and students. The greater part of it has been read by the author to a small body of earnest men—not all of them young—in the City of London. Some portions have been read (by deputy) to the Incorporated Accountants' Students' Society, Victoria, Australia, and (by the author) to the Chartered Institute of Secretaries, London. From time to time various problems arose and were discussed, and the result of these discussions will be found in this Primer on Foreign Exchange. There are at the present time a number of young people seized with the desire to know something more about the foreign exchanges than a few stray articles are able to tell them; for such this book is written. If it serve to point the way to a more extended path of study in this important branch of finance, its purpose will be more than achieved.

Many friends have assisted the author with valuable criticism and advice, and his best thanks for this service are due to Mr. E. Sykes, B.A.; Mr. Sidney Humphries, B.A., LL.B.; and Mr. E. J. Osborne, of Australia.

WILLIAM F. SPALDING.

LONDON.

8th February, 1919.

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A PRIMER OF FOREIGN EXCHANGE

CHAPTER I

WHICH introduces the reader to the study of the Foreign Exchanges; and shows the necessity for his reading, marking, learning, and inwardly digesting the subject.

I HAVE often wondered why it is that so few people in Great Britain take up the study of Foreign Exchange. Can it be that insular prejudice leads them to view with lofty indifference the ease with which the foreigner talks about the exchanges and the facility with which he deals in the money of other countries, or is it that we in this country have never given sufficient heed to the provision of teachers, both theoretical and practical, of the foreign exchanges? The probability is that both reasons are correct.

Of teachers theoretical there are not many; the practical teachers of the subject are fewer still, and, generally speaking, the practical men are not good exponents of their art; but, as a dealer once said to the writer, "there is a terrible lot of 'bunkum' about this foreign exchange bogey. We all hug ourselves and try to make other people believe we are masters of a most intricate and bewildering business, yet there is really not much in it. The subject only needs a little careful explaining to drive away all the mystery which we operators attach to it." Here is an illustration showing how helpless some of us are when we come to deal with the money of another country.

A brother the other day sent home to his sister straight from the battlefield in France, a twenty-franc note. Proud in the knowledge of the French he had learnt in France, he

mentioned that it was a small amount to help her to celebrate with due solemnity her *fête* day.

"What is it worth?" she said to another brother, a young bank clerk.

"Goodness only knows," said that youth. "Let's look in the paper."

After searching, he found the Foreign Exchange table where he read: "Paris—27·15." After a lot of argument, he and his sister came to the conclusion that the meaning was 27 decimal 15 francs for one pound sterling. They were about right, too, for the quotation simply meant that if a man in Paris had a cheque, say, on Barclay's Bank, for £1, he could possibly find a broker or banker there who would hand over to him in exchange 27 francs 15 centimes.

Having got thus far, however, our youthful friends were in a quandary: though but little knowledge of arithmetic was needed to arrive at the worth of their twenty-franc note. It ended in the brother agreeing to take the note to the City, where he handed it over to a foreign-looking clerk in one of the foreign exchange offices of a bank; and, note the sequel, this clerk simply scrawled a few figures on a piece of paper and called out 14s. 9d., which amount he proceeded to count out, and the boy accepted the money without knowing, or, shall we be kind to him and say, without troubling to find out, whether it was right or wrong.

Now, no self-respecting youngster in the City of London ought to be in that position; it does not need much thinking about when you come to look at it, to perceive that, given the equivalent of one pound sterling in French currency, all our young friend had to do was to divide 20 by 27·15, which would have given him the answer ·7366 = 14s. 9d.

Possibly one of the reasons for our failure to grasp this business of money-changing is our insularity: we are not in such close touch with other European countries as are nations like Holland, France, and Italy, who in places have, to use a colloquial expression, just to pop across the road to find themselves in a land where the money

is very different from their own currency. Owing to their contiguity, we may safely assume that the money of each country is constantly being found, or even tendered in the other; consequently, from his earliest days, the foreigner gets into the habit of giving his brain the mental twist necessary to calculate the worth of a given amount of the money of his own country on any particular day in another country. It may be said that when he starts business he has quite plainly mastered at least the elements of exchange, and, with a little study, he can soon acquire sufficient knowledge to enable him to operate, if not in all the currencies of the world, at least in the majority of the European systems.

An Englishman gets into the rut of dealing in pounds, shillings, and pence, and used rarely to get a chance of learning to compute the worth of one pound sterling on any particular day in any particular country. That was in the bad old days before the war; a new era is now opening, and there are signs that the young men of this country are now keen to learn all there is to learn about foreign exchange, in order to fit themselves to meet the foreigner on his own ground. For such this book is written.

Well, now, what is foreign exchange? There are only two words, but they represent a good deal, and if the reader has followed the painstaking efforts of the boy and girl in their endeavours to get a twenty-franc note cashed, he will be able to understand that FOREIGN EXCHANGE means the exchanging of the money of one country for the money of another country. Even so, something more is required of us before we can be proud of our ability to operate in foreign exchange. We have not only to know how to exchange pounds, shillings, and pence for, say, francs and centimes, or how to sell lire and centesimi for British currency, but have also to find out the precise moment to do it. In a word, we have to learn what to do, how to do it, and when to do it. We have also to learn with whom to do it; and how, first, to obtain the largest number of francs and centimes if that is the unit with which we are dealing, for each pound

sterling we surrender when buying; and, secondly, how to surrender the smallest number of francs and centimes to each pound sterling we receive when selling. In other words, we should learn how to obtain the best of the bargain, no matter in what currency or in what country we are dealing.

So much for the practical work; but then there is the theory. So many persons say: "Bother the theory, give me the practical work," "An ounce of practice is worth a pound of theory," and so on. Yet, with all due respect to these folk, it is submitted that, taken all in all, the man who has a thorough theoretical knowledge of what might be called the inner working of his subject, is pretty sure to become the better man when it comes to the practical work. He will not be blindly carrying out operations without knowing the why and the wherefore; he will understand why a pound sterling is worth so many dollars and cents, or a Chinese tael worth so many shillings and pence, and with his grounding in theory, he may, and possibly will, avoid the pitfalls into which the man who has only practice to guide him is likely to fall.

Finally, let scoffers remember that foreign exchange is not one of those new-fangled subjects brought into being by the war. Money-changers have existed from the earliest days of token currency. Most students of the Bible know that every Israelite who reached the age of 20 was required each year to pay a half-shekel into the sacred Treasury. The offering was bound to be the Hebrew half-shekel; no other form or token would do, for an Israelite was forbidden to offer foreign currency to Jehovah. Persian, Greek, and Roman money was then in circulation, consequently some provision had to be made for changing these into the half-shekel, so money-changers, the forefathers of our modern foreign exchange dealers, came into being. Foreign exchange brokers to-day make a charge for their services, so did the Hebrew money-changers. "The fee for the exchange was called *collybus*, and the brokers who made the exchange *collybustes*." [1]

[1] Cf. *Biblical Antiquities, Customs, etc.* By Rev. H. Evans, D.D., etc.

Banking itself is merely an extension of money-changing; it has, in fact, developed from money-lending and money-changing, and as the earliest bank on record was a Babylonian house, kept by one Egibi, some 700 years B.C., the business of foreign exchange is a pretty ancient one.

The Greek *tapezitæ*, or money-changers, and the old Roman *publicani*, are, of course, familiar to most classical scholars. They appear to have had some method of transferring money from one country to another, for Cicero, the celebrated Roman orator, remitted money from Cilicia to Rome through one of these firms of *publicani*.

CHAPTER II

MAINLY descriptive of foreign exchange and the part played by the bill of exchange in foreign trade and foreign exchange.

I HAVE stated elsewhere[1] that foreign exchange is nothing more nor less than the business of buying and selling debts, a phrase which seems to have puzzled some people intensely; they could appreciate the collection of debts well enough, but why buy and sell debts, and where does the principle of foreign exchange come in, one was asked. Well, let us take a homely example. We will suppose Mrs. Angel is anxious to bedeck herself in one of those wonderful creations to cover the head for which Paris milliners are famous. The cost of this hat is, say £5, or, in French money, 125 francs (5 × 25, taking 25 francs to the pound for the sake of simplicity). Now Madame Beri, in rue Rivoli, Paris, will not send the good lady her hat unless she has the money in advance. It is necessary, then, for the Englishwoman to find someone in London who has got 125 francs due to him in Paris, that is, some person in Paris is indebted to some other person in London. Presuming this good fellow to have been found, Mrs. Angel purchases from him the right he has to this sum of 125 francs in France. She purchases a debt, no matter for the moment what form the evidence of that debt takes, and let it suffice to say that she sends it out to France to Madame Beri, who promptly sends the hat in exchange. The position is that the owner of this debt, this claim upon Paris, in London, wants his money in good old British pounds, shillings, and pence; francs and centimes are of no use to him here, so he sells them to Mrs. Angel, who then passes them on to Madame Beri, and the latter we may assume gets francs from whoever holds them in Paris. It was an exchange of British currency for French currency. In other words, we have simply an exchange of debts; one member of the community here was indebted to a tradesman in a foreign

[1] Cf. *Foreign Exchange and Foreign Bills*, by W. F. Spalding, pp. 4-5.

country, and in order to avoid the risk and expense of sending actual coin in settlement of the debt, she sought out another person here to whom a like sum was owing by a member of the community in the foreign country, bought up this debt, or the right to it, and then cancelled her indebtedness by assigning the foreign debt to her creditor. Multiply this little instance to take in the whole of the transactions in international trade, and you have the case in a nutshell.

It is quite apparent on the face of it that the question of trade underlies the whole business: the title to the 125 francs was probably sent to London in the first place in payment of some purchase made by a Frenchman, and, as we saw, millinery was the other item. All we have before us, then, is an extended form of the old system of barter; although money is the medium, or, so to speak, the connecting link, we have still an exchange of goods for goods. Mrs. Angel bought goods and became the debtor; the French people sold goods and became creditor. The debts cancel, and on examination we find that the basis of it all is trade—we have traded goods for goods, but we have not gone to the useless expense of exchanging bullion. We have made use of money in the form of credit to facilitate the exchange. Just imagine the waste of time, plus all the trouble, risk, and expense that would have been involved if each side had to settle its debts by sending actual coin! Francs 125 in French money would have had to be sent across the Channel on the one hand, and five pounds sterling in English gold sent to France on the other hand, and in each case the money would have had to wait in the country to which it had been shipped until some one wanted to buy this currency in settlement of debts, when the money would once more have had to cross the Channel.

The basis of foreign exchange, it is plain, is international trade; it mostly concerns the settlements made in international trade, and we shall get a better idea of its working if we pause a moment to examine what takes place in home or domestic trade. In ordinary retail transactions our

convenience is mostly served by means of the token coins provided by the Government, but if we want to make purchases from distant sellers in our own country we pay by means of a cheque, postal order, or something of that sort. These are all "credit" instruments. As a precaution against loss, destruction, or theft, a person hands over his money to a banker, who then opens an account in his name. The banker is the debtor and the person depositing the money the creditor, and if the latter wants to purchase, say, a pair of boots from Northampton, or lace from Nottingham, he transfers a part of this credit to the seller of the goods; to put it another way, he sends him a piece of paper, called a cheque, or to give it its legal definition, a bill of exchange, drawn on a banker, payable on demand, and this cheque entitles the receiver, called the "payee," to a sum of money, the equivalent of the purchase in question. It is the same with the Postal Order; you pay your money to the Postmaster-General or his accredited agent; he is thus your debtor and you are the creditor. What you have purchased is a credit instrument which entitles the man to whom you send it to the sum of money mentioned therein. The operation resolves itself into a transfer of credit from one person to another.

Credit in trade is largely made up of promises, written promises to pay, and it does not matter whether it takes the form of a promise to pay to-day, to-morrow, or any far distant date, or whether the promise is in the shape of a claim on a third party, *e.g.*, as with the cheque on the banker, the Postal Order on the Postmaster-General; the principle is the same in all cases. This business of credit or the transferring of credit has been carried on for many ages. You will notice in the Bible that the good Samaritan gave the innkeeper two pence and a promise to repay whatever else he spent: that was a form of credit.

Take an example from the inland trade of the country. Imagine for the moment that you are a timber merchant. You sell a quantity of timber to a cabinet maker in Shoreditch for £100. He does not want to pay the £100 until he has

made the furniture and sold it for cash to the young man who has decided to join the noble army of benedicts. The procedure will be for you to draw a bill of exchange on the cabinet maker. This bill, by the way, will be drawn on a piece of paper bearing an impressed revenue stamp for 1s., and will probably be in the following form—

Exchange for £100 *London, 30th Nov.,* 1919.

Stamp
1/-

Three months after date pay to my order the sum of one hundred pounds—value received.

Tom Jones.

To Isaac Moses, Esq.,
Curtain Road,
Shoreditch.

The next step is to present this bill to the cabinet maker, and he writes across it the words "Accepted—payable at the London Joint City & Midland Bank, High Street, Shoreditch—Isaac Moses." Now this bill is payable three months after the date it bears, that is, on the next 3rd March (30th November to 28th February = 3 months, plus 3 days grace allowed for payment under English law). All you have got then for the furniture maker's debt to you is this piece of paper—you do not want to keep it for three months, you want your money, so what you do is to write on the back "Pay to the order of Barclay's Bank—Tom Jones"—presuming Barclay's to be your bankers. Then you go to your banker, and he, having funds to invest, will be ready to buy the bill from you—less a certain discount. You have sold a debt and the banker has bought it. This credit operation is what we might term internal or domestic exchange, of which foreign

exchange is but an extension. Foreign exchange comprises exactly similar operations; the only difference is that you buy or sell foreign debts instead of home or local debts.

It is by means of this world-wide credit system that we are enabled to carry on our trade and commerce overseas; only in this case merchants, traders, and those who pay and are paid by means of a credit instrument, make use of what is called a bill of exchange. The origin of bills of exchange is uncertain, and it cannot be said definitely by whom they were first invented or used. Pothier was unable to find any trace of them among the Romans, but it is known that Cicero made use of something closely allied to the bill of exchange. One of his Roman friends had money due to him at Athens, and Cicero ordered this man to make it payable to his (Cicero's) son at that place. The friend therefore wrote to his debtor in Athens ordering him to pay a certain sum of money to Cicero's son. That order may not have had all the attributes of the present day bill of exchange, but at any rate it was evidence of indebtedness. Bills of exchange were at first used merely as evidence of debt, though to be sure we read in some of the old romances of bills of exchange being given for property in bulk. Cervantes, in his great romance, makes that most lovable of all knight-errants, Don Quixote, give some such document to his trusty squire.[1] The bill runs—

"Dear Niece,

"At sight of this, my first bill of ass-colts, give order that three of the five I left at home in your custody be delivered to Sancho Panza, my Squire; which three colts I ordered to be delivered and paid for the like number received of him here in tale; and this, with his acquittance, shall be your discharge. Done in the heart of the Sable Mountain, this twenty-second of August, this present year."

It is the essence of the contract which the bill of exchange embodies that it should be signed, and Sancho, with a

[1] *Life and Exploits of the ingenious gentleman Don Quixote de la Mancha.* Sands & Co.'s Illustrated Edition. Chap. XXV, p. 123.

canniness unlooked for in such a fellow, was insistent upon this piece of paper being signed, but Don Quixote was adamant and would only give it his cypher.

Bills of exchange, as we know them to-day, appear first to have been used by the Florentines in the twelfth century; they were also used by the Venetians in the thirteenth century, and from the Venetians they drifted to other parts of the Continent, and, still later on, to England. In the first instance, bills of exchange were pieces of paper containing a record of one person's indebtedness to another. They were merely used to transfer trade debts from one place to another, and by that means avoid sending gold or silver; in that respect they are closely allied with the bills of exchange in use to-day, for, except in the last resort, we utilize them to save the cost, labour, and expense of remitting the precious metals.

Now, in order to satisfy legal requirements, a bill of exchange has to conform to certain principles, which apply, except in a few minor details, to bills of exchange in civilized countries the world over. According to English law, a bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it (the "drawer"), requiring the person to whom it is addressed (called the "drawee"), to pay on demand or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person (known as the "payee"), or to bearer.

A cheque, as we have seen, is a bill of exchange drawn on a banker, payable on demand. Note the difference. A bill of exchange need not necessarily be drawn on a banker, in fact it is more often than not drawn on a person other than a banker. Note, too, that phrase, a "fixed or determinable future time" in the bill of exchange. There is no question of futurity in the payment of a cheque, post-dating by impecunious cheque-book holders notwithstanding. Finally, unless the drawee elects to pay it on the spot, or it is drawn "on demand" or "at sight," a bill of exchange requires to be accepted, that is, the writing by the drawee of the words "accepted," the date, and in most cases, where payable,

across the face of the bill. So much for the form of the instruments; let us see how they are made to serve in this practice of foreign exchanges.

We will suppose there are four dealers, two in London and two in Paris. Mr. Apricot in London has exported jam to Jules Contey in France. Dreyfus in France has sent wine to Boniface in London. Note it carefully, you have got A and B domiciled in one place, C and D in another. A has sold goods to C, and D has sold goods to B, and what we have to do is to settle the debts and satisfy all parties with the modicum of trouble and the minimum of expense. With our lights, it will be evident that it is unnecessary for the Frenchman, Contey, to send a remittance to Apricot in London, and that Boniface in London should send money to Dreyfus in Paris; the business must be so arranged that one debt, or rather, the amount of one debt, can be utilized in payment of the other, in order that the double cost of sending metallic money may be avoided. Very well, then, if we assume for the sake of simplicity that the two debts are for equal amounts and time does not enter into the question, the operation will work out in the following way—

Apricot will draw a bill of exchange on Paris for, say, 2,525 francs on Contey for the jam he supplied. He sells this bill, this evidence of Contey's indebtedness, to Boniface for, say, £100 (taking £1 = 25·25 francs, then 100 × 25·25 = 2,525 francs). Boniface in turn sends it to Dreyfus in settlement of the wine the latter had exported to him; Dreyfus, on receipt of the bill, presents it to Contey, and the latter, like the good, honest chap he is, pays up, and the two transactions are closed to a point. True, it seems like tempting Providence to get the reader to draw on his imagination in following out this hypothetical case of foreign exchange; nevertheless, it does show that if you had two debts in two different countries, you could settle them by means of this ubiquitous piece of paper, without the intervention of a single piece of metallic money. Of course, we have taken a good deal for granted in this exchange of debts: we have assumed, for example,

that both debts were payable at the same date, that both shipments were made about the same time, that all the parties knew each other, and were thus able to get into contact and to complete the dealing. We have done this, however, merely to give an indication of how the principle of foreign exchange arises, so the end justifies the means. But in practice four parties to such a transaction are hardly likely to know each other, and their dealings will be carried on by the aid of a middleman, who may be a banker, bill broker, or exchange banker, or some other party. The middleman's services are useful and economical in that he saves the bother and expense of two parties having to draw bills ; it is through his intermediary that it is found to be necessary only for one to draw and the other to remit. Goods, of course, are really capital, and it is this middleman who overcomes the difficulties of conversion, simply by means of the purchase and sale of bills of exchange, or, in other words, by the purchase and sale of foreign exchange. Actually what happens, only the happening may be obscured by various factors, is that the first parcel of goods is sold for bills of exchange and the second bought with these bills of exchange.

What it is particularly desirable that the reader should note, too, is the striking part played by the bill of exchange in international commerce; just as countries like Great Britain and the United States have by their adoption of the cheque made for a tremendous economy in home and domestic trade, so have those countries in which the bill of exchange is most widely used really made use of the greatest of all money saving media in their international trade. Also, it must never be forgotten that the bill of exchange is in ninety-nine cases out of a hundred the representative of goods, and it does not matter whether the goods are sold or whether they merely form the medium for the transfer of capital; the principle, as far as foreign exchange is concerned, is the same. Capital is often transferred direct from one country to another, but on other occasions it may be transferred in all sorts of roundabout ways. For example, Great Britain

wishes to send capital to Belgium; she might do this by shipping building materials to Antwerp to the value of the sum she wished to place at Belgium's disposal, but she might also effect the operation by transmitting bills of exchange drawn on Paris, and with these bills of exchange Belgium might ultimately purchase her building materials from Holland. Later on, Belgium might repay the capital advanced by sending Great Britain bills of exchange received from Germany in payment of a war indemnity. These bills we may assume to be payable in London, and were received by Germany in payment of goods she had shipped to the Argentine. The importers of German produce in South America had paid Germany by means of bills on London, these Germany had transferred to Belgium, and Belgium in turn transferred them to London in settlement of indebtedness, where ultimately the bills were paid.

Two things arrive out of our preliminary investigations; that the basis of international indebtedness is foreign trade; secondly, that from this international indebtedness arises the problem of foreign exchange. Foreign exchange has been defined as the buying and selling in one country of debts due in another country, and that statement may be taken as approximately correct if we regard this dealing in foreign exchange in the same light as dealing in any other commodity. Debts arise in a multitude of ways, and international debts are no exception to the rule. They may arise between persons, they may be for goods sold, for services rendered, for ships taken over from one nation by another in a foreign port, or for loans negotiated. They are all debts, and it will tend to simplicity if we can treat them as debts, since the purchase and sale of foreign exchange is carried on in exactly the same way as if we were dealing in, say, tea and sugar. Moreover, operations in foreign exchange are subject to precisely the same influences with which we have to grapple when dealing in any other commodity. Some people find difficulty in regarding foreign exchange as a commodity, because they say there is no tangible evidence of the commodity with

which they are expected to deal. The reply obviously is, that you have material evidence to hand, in most cases in the shape of the bill of exchange, which, besides being evidence of indebtedness, is your commodity in a tangible form. It is a commodity which was brought into use as a substitute for gold, and it is only when demand exceeds the supply and the price of our commodity rises beyond certain set limits that resort is had to gold in settlement of international indebtedness. We speak of legal tender in home trade, but in international trade there is no legal money, properly speaking. Gold coins and gold bars are accepted on certain fixed ratios based on their bullion content, and as such they pass and in actual fact are accepted only as goods. Before we get to that point, however, the equilibrium of the trade position of the country is disturbed. It is as true to-day as ever it was that exports pay for imports, and this fact has been brought home more strongly to us of late years, when we have seen the effect on the exchanges caused by the enormous amount of invisible imports and exports (*i.e.*, shipping, services, allowances to soldiers and sailors, their allotments of pay to home dependents, and a hundred and one of the things which those who fail to look beneath the surface never perceive). The liquidation of all this international trade, whether visible or invisible, is carried out by exchange dealings, and the visible token of the commodity is that which has been described as a wretched, crinkled, scrawled over, blotchy, frowsy piece of paper, but which we dignify by the name of a "Bill of Exchange."

With all due deference to the language of politicians, it is a wonderful thing this bill of exchange, particularly the bill of exchange on London, which, in so far as there may be said to be any world currency, may be said to be the currency of all the world. It is in demand because it represents and gives the inalienable right to so much gold; but it is better than gold, and is preferred to gold because by its use we avoid the cost of transportation and the loss of interest incidental to gold shipments, added to which it is transferable

with infinitely greater rapidity than gold, with greater ease, with greater certainty, and last, but not least, it is transmissible with infinitely less risk of loss. The bill of exchange on London is the universal world currency, and it is the bill above all others which serves as the connecting link between traders, merchants, and financiers all over the world. It is this bill alone which the producers and handlers of the shipping of all nations will accept as wholly satisfactory and sufficient. There is nothing like it elsewhere, said an anonymous writer, and its present reputation dates from the gradual adoption of the liberty of trade policy recommended by that great statesman and seaman, Raleigh. It is striking, is this *rôle* played by the bill of exchange in international commerce, more striking still perhaps is the dominant position achieved by the London bill, and if we are to keep our name in that connection always on the top, we must know and understand more thoroughly in the future than we have in the past the little intricacies connected with this money substitute.

We have got a pretty good idea of what is the utility of the bill of exchange in foreign exchange. Let us now proceed to investigate some of the inner workings of this thorny subject, and endeavour to see for ourselves what are the bases for the calculations so mysteriously hidden under the verbiage and market jargon of bankers, exchange dealers, and the like.

CHAPTER III

The principal currencies with which the foreign exchange student has to deal—Chain Rule—The Mint Par of Exchange.

We have seen so many times that mantle of aloofness in which the Englishman delights to wrap himself, but in foreign exchange he has got to cast it off; he has to come out into the open, to interest himself in the ways of the ambitious foreigner, he has to learn as much about the latter as he can; his trade, his currency, the countries with which he deals, in fact he ought to aim at learning all there is to learn; then he may meet the foreigner on his own ground, and, let us hope, be all the better friends with him afterwards, even if he is a competitor. It is no use imagining for one moment that all transactions will be carried out in our own beloved sterling; even if the bill on London does hold triumphant sway throughout the world, it has time after time to be exchanged into other currencies, and unless we know something of other currencies, we are likely, to use a Chinese expression, to get badly "squeezed" in the process, if nothing worse.

As a jumping-off ground for the other countries, let us take the currency of our own land, about which we are supposed to know all there is to be known.

Our currency standard is the Gold Standard, our unit of currency the sovereign, or as most foreigners and a few Englishmen call it, the pound sterling. It is curious what a hazy idea some people have as to the precise meaning or signification of this pound sterling of ours. Blackstone says, "the denomination or the value for which the coin is to pass current, is likewise in the breast of the King; and if any unusual pieces are coined that value must be ascertained by proclamation. In order to fix the value, the weight and the fineness of the metal are to be taken into consideration together. When a given weight of gold or silver is of a given fineness it is then of the true *standard*, and is called sterling. Of this sterling metal all the coin of the Kingdom must be

made by the Statute 25, Edward III, cap. 15; so that the King's prerogative seemeth not to extend to the debasing or enhancing the value of the coin below or above the sterling value; though Sir Mathew Hale appears to be of another opinion."

It is not stated what particular view Sir Mathew Hale held on the subject, but there is little doubt that the word "sterling" originally meant "pure standard." As a matter of fact, there were a good many base coins in circulation in England during the thirteenth century, and an attempt to introduce a better state of affairs was made by availing of the services of certain German coiners, who were called to England to assist in minting the current coins. These men were known as "Easterling," and they were noted for the purity of the coins they were able to produce. The coins minted with the assistance of these coiners were called "Sterling," and although the word seems to bear a different significance to-day, we may take it that this was the real origin of the word. Still, we live in the present, and for present purposes we have to observe the currency as laid down by British law. The English Coinage Act of 1870 fixes the weight of gold contained in the English sovereign (or one pound sterling) as 123·27447 grains troy, but in foreign exchange the weight of a coin is nearly always given in its metric equivalent, that is in grammes. The metric weight of the sovereign is 7·98805 grammes, known as eleven-twelfths fine, which being interpreted means, that of the gold contained in the sovereign eleven-twelfths of it is pure gold, while the remaining twelfth is made up of alloy. Gold, it need hardly be stated, is legal tender up to any amount, silver up to 40s., copper up to 1s. We may take it for granted that all our readers know that the abbreviations, £ s. d. are Latin and mean *libræ*, *solidi*, and *denarii*, respectively. During the Great War there have also come into being Currency Notes for one pound and ten shillings. The Act authorizing these is the Currency and Bank Notes Act, 1914 (4 & 5 Geo. 5, c. 14). Briefly, that Act gave the British Treasury authority to issue

currency notes for one pound and for ten shillings, and, according to Sec. 1 (1) of the Act, the notes are current in the United Kingdom in the same manner and to the same extent and as fully as sovereigns and half-sovereigns are current. They are, therefore, full legal tender in the United Kingdom for the payment of any amount. They are repayable in gold, for, according to Sec. 3 of the Act, the holder of a currency note is entitled to obtain on demand, during office hours at the Bank of England, payment for the note at its face value in gold coin which is for the time being legal tender in the United Kingdom.

Neither cheques nor bills of exchange have this legal tender quality conferred upon them; they are merely signs and symbols of the debts which they serve to transfer, and as such are hedged about by a variety of legislative enactments, not only in this country, but in almost every other country in which they are used as substitutes for gold. It remains to add that our present gold coinage dates from the year 1816.

So much for the money of our own country. It will also be necessary to know the monetary units of a few other countries with which our principal dealings in foreign exchange take place.

First we get a group comprising what is known as the Latin Union. Under this heading come five countries practically all on the same currency basis. There is France, whose unit is the franc, which is equivalent to 100 centimes; Belgium with the franc equivalent also to 100 centimes, for its unit; Switzerland also has the franc currency—1 franc equal to 100 centimes. The Italian unit is called the lira, and 100 centesimi make 1 lira. Greece entered the Latin Union in 1867, but did not actually conform to its terms until 1875. The unit is the drachma of 100 lepta. Germany is all by herself with the mark, which is equal to 100 pfennig. Austria has the krone of 100 heller. Russia calls her unit the rouble, which contains 100 kopecks. The word "rouble" comes from the word "Rublj," which means a piece cut off, and recalls the time when silver was in rods, from which pieces according to the value of the exchange to be effected were

cut off. Sir Charles Addis, in a preface to a book on silver,[1] says: "The weight or value of each piece having thus been established for a single transaction, this led by a natural transition to recording the weight of each piece of silver by a stamp or punch on its obverse or reverse, so as to make it available for any similar operation in future without the necessity of re-weighing it on every fresh occasion of exchange. The effect of the blow struck by the punch or stamp was to flatten the piece of metal into a round form, and to this no doubt may be ascribed the circular form which our modern coinage has practically universally assumed." It is curious that the name of the Russian coin of all others should be the one to perpetuate these facts. Holland's currency unit is the florin (or guilder), equal to 100 cents. Formerly the florin was equal to 20 stuivers, 1 stiver (or stuiver) being equivalent to 5 cents. Then we get the Scandinavian Union, which includes Denmark, Sweden, and Norway. These three countries all have for their unit the 1 krone piece and 100 ore go to make 1 krone. Spain is as easy to remember as the others, her currency being pesetas and centimos; 1 peseta is equal to 100 centimos. Portugal has the milreis for her unit, and 1,000 reis are worth 1 milreis. The currency of the United States of America is the dollar, equal to 100 cents. Canadian currency is also made up of dollars and cents. Argentina has the peso (frequently called the dollar), equal to 100 centavos; Brazil the milreis, equal to 1,000 reis (the customary amounts spoken of are contos of reis: 1 conto = reis 1,000,000, generally written 1,000$000, which represents 1,000 milreis; 1 conto of milreis = 1,000,000-$000, and is usually termed "1 conto di contos"); and Uruguay the 1 peso subdivided into 100 centavos. Egyptian currency is rather complicated. The unit is really the piastre, and 100 piastres make 1 Egyptian sequin or pound (E. £1), although its actual worth is only 98·45 piastres; which gives an equivalent of about £1 0s. 6d. in British currency. The nominal worth of the British sovereign in Egypt is 97·50

[1] *Silver: Its History and Romance.* B. White.

piastres. When we come to the countries of the East, we find them nearly all with one form or another of the decimal coinage; Japan has the yen of 100 sen, Hong-Kong the dollar of 100 cents; Shanghai the tael of 100 cents, the Straits Settlements with the dollar of 100 cents, and so on; but the student of foreign exchange, in its elementary stages at least, will not need to worry much about Eastern currencies. India, of course, has the rupee, equal to 16 annas. She also uses largely the British sovereign, and lately has commenced coining a gold mohur of the same weight and fineness as the sovereign. However, these are questions which do not concern us at this stage.

It does not follow that the student has to commit all the monetary units to memory. By practice they will soon become impressed on his mind, and after a few days of operating, the money-changer, for that is what dealers in foreign exchange are, will not be found asking for a quotation for lira when he wants francs, or for a rate for piastres when he means pesos. However, having these foreign equivalents put before us, and having registered a mental vow that we will have them off by heart to-morrow—that to-morrow which is always the battle-cry of fools—we may proceed a step further on our journey and endeavour to find out how it is that we are called upon to pay more one time for the means of settling a foreign debt, and receive less at other times for the foreign debt which is owing to us.

As we shall see presently, demand and supply operate in exactly the same way in regulating the price paid for and received for foreign debts as they do in regulating the quotations for other commodities. In fact, the fundamental and actual basis of the price of all other commodities (always supposing there is no controller fixing prices, or no exchange committee to bolster up exchange artificially) is the ratio of supply and demand. That part may be easily understandable or easily teachable. Your novice, after a little study, will quite well comprehend when the price of a bill of exchange is higher and when it is lower, when it rises or when it falls,

when exchange is at a premium and when at a discount, as the market may elect to call it. Perhaps he will also comprehend that when demand exceeds supply, rates will increase to their utmost limit, and when supplies increase these same rates will fall, but being of an enquiring turn of mind, he may be pardoned for wanting to know the starting-point for our calculations. You may reply, in answer to an enquiry, that if he wants to pay a debt in Paris and the terms of settlement are bills of exchange payable three months after date, the price of the three months bill the foreign exchange dealer will sell him is based on the Paris cheque rate. That answer will not satisfy our present day student. "Why?" he will demand, in that tone with which poor baffled paterfamilias from Adam onward are so familiar. "Why do you take the cheque rate, and how is the cheque rate calculated, or what is the basis on which it is calculated?" Well, the fond father rarely, if ever, succeeds in satisfying childish curiosity, but we have, as it happens, in foreign exchange sufficient data to satisfy the most persistent enquirer, and curiously enough there is the paternal twang about it, too. We refer to what is known as the Mint Par, or, to give it its full title, the Mint Par of Exchange.

In the days before the Great War, those who knew little and affected to care less about foreign exchange, were wont to exclaim: "What's the use of worrying about such things as the par of exchange; we know that £1 is worth 25 francs, or 5 American dollars, or 12 Dutch florins, that's near enough." These people have needed the war to awaken them, for even before August, 1914, things were, so to say, not what they seemed. True, foreign exchange was so little taught that few outside and a good many inside banking circles might be pardoned for not knowing that in reality £1 was worth approximately 25 francs 22½ centimes, 4 dollars 86 cents, 12 florins 10 cents. Therefore, at the outset, such differences, amounting to from 1 to 2 per cent., must have led to a good deal of inaccuracy in accounts, to say the least of it.

"Par," divested of all the meanings lexicographers have

attached to it, is a simple Latin word meaning "equal." Your English dictionary will probably tell you that it means a "state of equality," "a norm," the latter term itself meaning an "authoritative standard." Some of the French dictionaries render the meaning (the word is "pair" in French), as: "Égalité de change entre deux pays"—equality of exchange between two countries, which is reading much more into the word than the original Latin was ever intended to convey. However, from an exhaustive analysis of the meaning of the word PAR we commence to get an insight into its connection with foreign exchange. Taking the dictionary meaning, exchange would be in a state of equality when the debts between any two countries or centres were on a given date exactly equal, or, to put it another way, when the debts due from country A to country B are compensated by those due from country B to country A. To be in that ideal state, neither of them would have imported from the other commodities to a greater value than it exported to the other—the debits and credits of each must compensate one another. To reach this equality of indebtedness, it is very evident that, not only must imports and exports exactly balance, but the debts would have to be in identical currency, payable at the same time; there could be no expenses for, say, stamp duty on bills of exchange, postage, or anything of that sort, and the supply of and demand for bills of exchange would themselves have to be brought to the exact point of equilibrium. Needless to say, that is a state of affairs which rarely if ever exists, and so purely theoretical is it, that economists unite in terming it the "Ideal" or "Hypothetical" par of exchange. It is hypothetical because there is, as Adam Smith pointed out, no certain criterion by which we could determine when the trade of any two countries balances, and as it is practically impossible at any precise moment to say exactly what the balance of trade between any two countries is, we are hardly in a position to place our finger on the pulse of exchange and say definitely that it is in this ideal state of equality; but as exchange, theoretically, is always tending

to the equation of the value of the gold in the coin of one country stated in terms of that of the other, gold countries have taken as a basis or starting-point, the Mint Par of Exchange, and this, which we may call the real par of exchange, would be in existence between any two countries, when, by paying a certain amount of the gold money, or its acknowledged equivalent, in one country, you can purchase the right to receive an equal amount of the same precious metal in the other country, the amount which you receive or pay being calculated according to the Mint Laws of the respective countries. When you pay or surrender more of your gold coins than fixed by the Mint Par for the bill of exchange to settle your foreign debt, you are supposed to be paying a premium, or in other words, exchange is against you or the country in which you are operating; when you surrender less of your currency units for the bill of exchange, exchange is said to be at a discount, that is, you get the premium instead of paying it; exchange is thus in your favour and against the other country. In the one case the rate is above the Mint Par of Exchange, in the other it is below the Mint Par of Exchange.

Now let us see how we arrive at this Mint Par of Exchange.

The first thing that is necessary is that the two countries between which we wish to ascertain the mint par must be adherents to the same currency standard. You cannot, therefore, have a mint par between one country on a gold standard and the other on a silver standard. Remember the rule, then, that to establish a mint par of exchange between any two countries it is essential that both must use the same metal for their full legal tender coin. Further, one must always bear in mind that the calculation is based on the respective Mint or Coinage Laws fixed in each country. We will take America as our first example, since the exchange between New York and London has been of such enormous importance during the war.

The English Coinage Act of 1870, as we have seen, lays down that the sovereign must weigh 123·27447 grains troy

of gold, eleven-twelfths fine. The United States currency unit is the dollar, but for the purpose of ascertaining the mint par they take the golden eagle, which, according to the U.S.A. Law is ordained to weigh 258 grains of gold, nine-tenths fine, so that the eagle really contains fine gold to the extent of 232·2 grains (258 × 9/10). Given these particulars, we have to arrive at the exact amount of gold dollars which will equal one British sovereign. Now how shall we work this out? The best way to do it is by Chain Rule, a mechanical method of arithmetic not much liked by mathematicians, but very useful all the same in exchange calculations.

The first thing that is required in Chain Rule is to be clear in your mind what it is you want to know. Having made up your mind you then start by stating your question; that is to say, you ask yourself the information you require, place it down in a left-hand column, and the fixed quantity about which you ask the question is put on the right. Then you carry over to the left the same heading of information as you already have on the right, and from it continue your chain of facts, until you arrive on the right with the same heading of information as that enquired about in your interrogation. Your chain now being complete, all you have to do is to multiply the figures of each column together, and divide the total of the left into the total of the right, the result is the answer to your enquiry.[1] Just to get a humorous illustration of the working of this rule, the reader might take the familiar catch question, to which we have heard dozens of different answers given: If $1\frac{1}{2}$ hens lay $1\frac{1}{2}$ eggs in $1\frac{1}{2}$ days, how many eggs will 6 hens lay in 6 days. Chain Rule gives you a short cut to this brain twister.

? Eggs laid by	6 hens in 6 days
If $1\frac{1}{2}$ hens in $1\frac{1}{2}$ days lay	$1\frac{1}{2}$ eggs

$$\frac{6 \times 6 \times 1\frac{1}{2}}{1\frac{1}{2} \times 1\frac{1}{2}} = 24 \text{ eggs.}$$

[1] Cf. *Chain Rule*, by H. Mackenzie.

A word of warning must be given in regard to the application of Chain Rule: the greatest care must be taken to see that each heading in the left-hand column is of the same denomination as the preceding heading on the right. If, for example, you have pence in your right-hand column, you must start the next interrogation with pence in the left-hand column. Finally, if your first question starts with pence, that is on the left-hand column, then you end with pence at the completion of the chain in your right-hand column.

Having wandered aside to discuss Chain Rule, let us return to our contemplation of the mint par between England and the U.S.A., and endeavour to apply the rule in working out exchange. Remembering what has been said about the bullion equivalents laid down by the respective coinage laws of the two countries, what we want to find out is the exact number of gold dollars equal to one sovereign, so we ask ourselves—

How many dollars	=	£1
If £1	=	123·274 grains Standard gold
If Standard gold 12 grains	=	11 grains fine gold
If 232·2 grains fine gold	=	10 U.S. gold dollars ?

To get the required result we have simply to multiply the figures of our left-hand column together, and then divide the total into the multiplication of the figures of the right-hand column, and the answer will be the Mint Par of Exchange required. We get as the result of our chain—

$$\frac{1 \times 123{\cdot}274 \times 11 \times 10}{1 \times 12 \times 232{\cdot}2} = \underline{4{\cdot}8665} \text{ dollars.}$$

4·8665 dollars is thus the number of dollars and cents which go to one pound sterling, and that is the invariable par of exchange between America and England which must exist as long as the gold equivalents called for by the respective mint laws remain as at present fixed. Some exchange books prefer

to put the equivalents the other way round, and quote the mint par in pence (*i.e.*, 49–5/16d. = \$1), but that, after all, is simply the pence in £1 divided by the mint par itself,

$$\frac{240}{4{\cdot}8665} = 49\text{–}5/16\text{d.}$$

The Mint Par of Exchange between England and France can be similarly calculated. The French law says that 155 twenty-franc gold pieces, weighing 1 kilogramme of gold, 900 fine, shall be coined into 3,100 francs (155 × 20). By Chain Rule we get—

? Francs	= £1
If £1	= 7·98805 grammes Standard gold
If standard gold 12 grammes	= 11 grammes fine gold
and fine gold 900	= 3,100 francs.

$$\frac{1 \times 7{\cdot}98805 \times 11 \times 3{,}100}{1 \times 12 \times 900} = 25{\cdot}22152 \text{ francs.}$$

Francs 25·22152 is thus taken as the exact equivalent of one British sovereign, but, as the reader will have perceived, no account is here taken of light or worn coins, though, of course, in actual practice such coins would either be refused altogether or an allowance claimed for the loss of weight. In any case our little calculation shows that one pound sterling is worth nearly 1 per cent. more than he who calls the equivalent 25 francs was aware, and the instance goes to impress upon one the need for exactness in equivalents when dealing in foreign exchange. One more example may be given to illustrate this. Let us take Holland. The gold coin for the purpose of exchange is the ten-florin piece, which weighs 6·720 grammes, 900 fine, it therefore

contains 6·048 grammes fine gold. The following is the calculation—

? Florins	= £1
If £1	= 7·98805 grammes Standard gold
If Standard gold 12 grammes	= 11 grammes fine gold
If 6·048 grammes fine gold	= 10 florins.

$$\frac{7{\cdot}98805 \times 11 \times 10}{12 \times 6.048} = \text{Florins } 12{\cdot}107$$

which is the mint par between England and The Netherlands.

For the purpose of reference, we may draw this chapter to a fitting conclusion by giving the Mint Pars of Exchange between Great Britain and several of the more important exchange centres.

Mint Par of Exchange between England and	France .	s. 25·22152
,, ,, ,, ,, ,,	U.S.A. .	$ 4·8665
,, ,, ,, England and	France Belgium Italy Switzerland	The Latin Monetary Union Fcs. 25·2215
Mint Par of Exchange between England and	Spain .	Pesetas 25·2215
,, ,, ,, ,, ,, ,, ,, ,, ,, ,, ,, ,, ,, ,, ,,	Denmark Sweden Norway	The Scandinavian Monetary Union Kroner 18·15982
Mint Par of Exchange between England and	The Netherlands	Fl. 12·107
,, ,, ,, ,, ,,	Germany	Marks 20·43
,, ,, ,, ,, ,,	Austria	Kronen 24·02

CHAPTER IV

The mint par of exchange and the gold point—Faith, Hope and Charity in an exchange transaction with Peace.

Having now got comfortably ensconced at the back of our minds what the Mint Par of Exchange really is, we can very well see how it is applied in practice. Let us suppose that the imports and exports between England and Holland exactly balance, that the debts and credits were in that much-talked-of state of equality in which the one nation had not more to pay than the other had to receive, and that on that particular red-letter day Mrs. Faith in London had to pay Mrs. Hope in Amsterdam one hundred pounds sterling for Dutch clogs, which the former had instructed Mrs. Charity in Amsterdam to send to Belgian refugees. The Mint Par of Exchange, as we have seen, is florins 12·107; Mrs. Faith, then, will go to her banker, Mr. Peace, and will ask him to sell her a bill of exchange drawn on Amsterdam for the equivalent of £100, the exchange being at par, she will get 1,210 florins 7 cents (12·107 × 100). For the sake of clearness in our illustration we have assumed that the banker, actuated by charitable sentiments, has foregone the charge for stamps and any commission to which he might be entitled on the bill. The example is given to show how easy it is to calculate the exact number of foreign units to one pound sterling, once we know the basis upon which to make our calculation.

The Mint Par of Exchange between the various countries serves another useful and very important service in foreign exchange; in each case the mint par forms a definite point around which exchange oscillates, and these limits, namely, the rates of exchange above and below the par of exchange, are known as the specie or gold points. Specie points, or, as they are perhaps more commonly called, gold points,

represent certain fixed limits within which, in normal times, the exchanges fluctuate. The Mint Pars of Exchange constitute the "hub," and the gold points the "limits" of exchange fluctuations. Theoretically, they represent the range within which "spot" or "sight" exchange moves, and as long as the free passage of gold is allowed by the various countries, or their State banks, there should be a constant ebb and flow of gold from one country to another when the rates reach these points. In time of war, or of political stress, such as we were going through in the year 1918, the points may be obscured or even hidden altogether, but that does not detract from the theory one whit.

Let us investigate a little further to see what these mysterious specie points really are.

In normal times, shippers, merchants, manufacturers, and all sorts and conditions of men who were under the obligation to remit money to foreign countries, were said to be willing to purchase bills of exchange for the purpose of settling their indebtedness only so long as the cost did not exceed the cost of sending gold in lieu of bills of exchange: that represents the upward limit of exchange, or what we call the export gold or specie point. The opposite limit is reached when exchange falls so far below the mint par that the sellers of bills will rather draw gold from the other country than sell their paper at the lower price; this is known as the import specie point. The outgoing specie point of a country is the rate of exchange at which gold leaves the country, and the incoming point is the rate at which gold enters a country, that is, of course, other things being equal. With practically every country in the world hanging on to its gold, these limits are passed and surpassed, they have even disappeared, although the principle is that gold neither enters nor leaves a country until the last resort, but the gold points remain all the same, though it may be many days before they are in operation again.

Practically speaking, all that the specie points represent is the rate of exchange produced by buying gold in one

country and selling it in another at certain fixed prices; but those whose business it is to do this, do not need to worry about such operations until they see that the rates of exchange in operation between any two gold standard countries make it expedient or worth their while to undertake this operation.

In speaking of these gold points, it has become almost a habit to say that the merchants and others, in default of being able to work at such and such a rate, will send or claim gold, as the case may be; but even in the halcyon days before the war, the ordinary variety of operator in exchange rarely, if ever, touched gold; he left that part of the business to the bankers or bullion brokers, whose privilege it was to "manufacture" him a bill of exchange or provide him with some other form of remittance if commercial paper was not forthcoming at the ordinary rates of exchange. However, of this we shall have more to say anon. The upward limit of exchange now demands our attention.

We will revert to dealings with the United States of America once more. We saw that the mint par was \$4·8665; when the rate of exchange goes up, say, to \$4·88, it turns in favour of London, and if this is due to the excess of our exports over imports, that is to say, if the balance of trade be in our favour, the remittance to us of bills of exchange from the U.S.A., either on British firms or on foreign countries, may in time offset the rate which is unfavourable to America, or, if they are not sufficient in quantity or amount to do that, the bills may serve to keep the extreme rate of exchange in suspense, so to speak. The rate may possibly move backwards and forwards like the swing of a pendulum for some time, but in due course the balance will generally swing round once more, and exchange reach, say, \$4·89, when we should expect gold to start flowing to England, that is, assuming shipping and other charges to be on a pre-war basis.

At \$4·89 gold should come from New York to London; that is our import specie point.

At \$4·827 gold should leave London for New York, and that would be our export specie point.

It is very difficult to reconcile these rates with those in force in time of war, but, nevertheless, it is within these rates that fluctuations in exchange usually occurred before the war, and doubtless that is the range within which exchange will move sooner or later after peace is declared. The difficulty about these theoretical gold points even before the war was, that exchange did not move exactly within the assigned limits; sometimes the rate was higher than the import gold point and gold did not enter a country; sometimes it fell below the export point and gold did not leave a country. In some cases the reason was that countries like Germany, who were intent on building up huge gold reserves, and—maintaining them—were prone to place serious difficulties in the way of gold shippers; they tried hard to get gold into the country, and worked much harder in order to stop its leaving their shores. In other cases, the points were affected by variations in freight charges, cost of packing, and insurance; then some operators enjoyed privileges not obtainable by others; finally, there was the allowance for worn and light coins which often had to be taken into account. War risk insurance has always been an important and troublesome factor, too.

If, as it seems, that these specie points cannot be fixed with absolute precision, why do we still take cognizance of them? The answer is that, as nearly all the monetary systems of the world are based upon gold, and the relationship between their respective monetary units has been definitely fixed in accordance with the grains of gold contained in the said monetary units, it follows that the bankers, who usually have the last say in these matters, will not in normal times sell bank bills of exchange, that is, bills which ordinarily represent a claim to so much gold currency in another country, at a higher exchange than that at which a banker could purchase in the foreign country an equivalent quantity of gold, which, taking into account the cost of transmission from that country, will out-turn the number of gold coins required to settle his indebtedness in his own country. For example

take the French exchange. At francs 25·32½ gold, ordinarily should begin to flow from Paris to London. Now suppose your banker has been steadily selling bills drawn on Paris until he is surrendering, say, 25 francs 32 centimes to each sovereign you hand over to him, then imagine that the rate jumps to 25 francs 32½ centimes, and you go to him and offer him £1 for that number of francs and centimes, he will, always supposing there is no such nightmare as a war in progress, refuse your offer point blank; at the rate in question, that is 25f. 32½c., he knows very well he can afford to purchase gold in France and ship it to London; when it arrives in London he can sell it to the Bank of England, and with the money he receives from that venerable institution he can put himself in funds once more.

Similarly, the banker will not buy bills of exchange at a lower exchange than 25 francs 12½ centimes to £1, which is normally the rate at which gold goes from London to Paris. Sooner than buy bills of exchange which will produce only that amount of francs in France he will elect to buy gold in London and send it to Paris, sell it to the Bank of France, and with the francs and centimes thus received he is able to settle his indebtedness in France. We have given two isolated examples, but if the reader will envisage hundreds and thousands of similar debts in process of liquidation at any given moment, he will soon begin to comprehend how international indebtedness is cancelled, and how it is that exchanges are constantly pulled one day this way, another day that way.

You see the position is this: the rate at which a banker will sell bills of exchange drawn on a foreign country depends chiefly upon the rate of exchange at which he can cover his drawings. If he sells bills for francs and centimes, naturally he is bound to see that the person upon whom the bill is drawn has sufficient funds to meet the bills or aggregate of bills so drawn. To cover these drawings he buys bills of exchange in or upon the other country, or he may even purchase bills in a third country and remit them to the centre

upon which they are drawn, and when all these bills are encashed, funds in due course will go to meet the bills the banker has previously sold. The limit of the rise or fall of exchange marked by these specie points will depend, then, on the rate at which it will pay the banker in the one case to draw gold from the foreign centres and in the other case to send gold to the foreign centre in settlement of indebtedness, and in all ordinary circumstances the fluctuations in the rates of exchange between any two countries conforming to the same monetary standard are practically confined within the set limits. Exchanges may go a little higher or a little lower, but in the end the extreme points are found to be governed by the cost of transmitting gold. Therefore, as a general rule, it may be taken that the outgoing or export gold point is ascertained by deducting the cost of transmitting gold from the Mint Par of Exchange, and to find the incoming or import gold point we add the cost to the mint par.

Take the American exchange again—

At £1 = $4·890 gold should leave New York for London.
At £1 = $4·866 exchange is at par.
At £1 = $4·827 gold should leave London for New York.

Mint par needs no further explanation, and a short examination will show us how the gold points are calculated from the mint parity. The normal charge for sending gold from America to London and converting it into pounds, shillings, and pence is 5 per mille, that is, 5 cents on each 1,000 cents. For shipping gold to New York from London the usual cost is 8 per mille. The reason for the extra 3 cents per mille in the latter case is easily explained. It is due to the fact that although American shippers can always find ready purchasers for bills on London, bills in the reverse direction—London on New York—are not at all plentiful, consequently, on the assumption that the British shipper of gold to the States has to await a return remittance, there is some loss of interest, and to make good this deficiency, the extra 3 per mille is imposed. Very well, then, to revert to the gold

coming from New York to London, at $4·89 to the pound sterling, this is how we figure it out—

Mint par being	$4·866
We add for our Charges, Freight, Insurance, Commission, and any other incidental expenses like Packing, etc., 5 per mille	·024
	$4·890

and thus get a rate of exchange which we call our Import Gold Point. To find our Export Gold Point, or the rate of exchange at which gold is expected to be sent from London to New York, we again start with the mint par, but, deducting the charges instead of adding them, our little sum is—

Mint par	$4·866
Charges for Freight, Insurance, Commission, Loss of Interest, etc.	·039
	$4·827

London:		New York:	
Gold in.	*Gold out.*	*Gold in.*	*Gold out.*
Bills received from New York — entitle receivers to so much sterling, *i.e.*, gold currency. It will be possible to pay them in gold forthwith, as metal is already received from New York	Bank Bills drawn on London are presented for payment, gold handed over—sent to New York. Bank there waits until gold arrives. Loses interest for time metal is *en route*	Bills offering—banks buy at or near Specie Point. Send to London—present bills—receive gold—are out of interest on money expended in purchase of bills until gold arrives in New York	Bills are wanted on England, so Banks sell at or near specie point for gold. The gold is then sent to London in time to meet bills drawn. In this case there is no loss of interest.

With these examples before him, the student will follow easily the calculations necessary to arrive at the gold points for the other centres. Let us start with France.

On the assumption that post-war conditions will be the same as the *ante bellum* conditions, to draw gold from the Bank of France and sell it to the Bank of England, after taking into account freight and all other charges, would cost about 4 per mille, that is, approximately, 10 centimes to £1. The same charges will be incurred if we can persuade the Old Lady of Threadneedle Street to let us have gold to ship to France. Therefore, when the French exchange, or, as we shall presently call it, the Paris cheque rate, is—

At fcs. 25·32½c. to £1 gold will go from Paris to London.

At fcs. 25·22½c. to £1 we shall get the Par of Exchange.

At fcs. 25·12½c. to £1 the gold will leave London for Paris.

In the case of Germany it costs rather more to send or to receive gold: the expense of shipping and realization of gold drawn from the Imperial Bank of Germany (the Reichsbank), and selling it to the Bank of England, and *vice versâ*, may be taken as 5 per mille, consequently, when exchange between London and Berlin is—

At Mks. 20·53pf. it will pay us to take gold from Berlin and sell it in London.

At Mks. 20·43pf. we get the par of exchange.

At Mks. 20·33pf. we should expect to see gold go from London to Berlin.

In times of peace these specie points represent the usual range within which exchange moves, and as long as there are no restrictions on gold shipments, the metal will flow from one country to the other when the rates reach the various import and export specie points. However, even in ordinary circumstances it is not uncommon for exchange to be allowed to move outside these limits, but all bullion dealers know that in such circumstances the eventual result is heavier gold shipments, which naturally cause rates to move back with a jump—a state of affairs which exchange operators dislike more than anyone. Of course, great political events which sometimes restrict gold supplies, and great wars which sometimes stop them altogether, cause the rates of exchange for bills payable on demand, under which heading we include

cheques and bills payable at sight, to move quite beyond the ranges indicated, but the position then is much the same as when the free play of demand and supply of commodities is interfered with; it is artificial, and despite the expedients which nations resort to in their endeavours to correct matters, exchange manipulation is a difficult and anxious business.

The three exchanges we have examined, the United States, France, and Germany, are the three principal gold exchanges, and it is between these three countries that the greatest ebb and flow of gold normally takes place. Gold is, however, frequently exchanged between London and the other European financial centres, but most of them do not work on fixed gold points: tariff rates for gold exist in countries like Holland and Spain, which pay for the metal prices laid down by their State Banks. In such cases, we get the real gold points by finding out the actual prices paid for gold, and working out what rate of exchange will be produced by buying the metal in the one country, say, England, and, after paying freight, insurance, and all other charges, selling it in the other country. Bearing these facts in mind, the approximate gold points for the Netherlands and countries of the Scandinavian Union (Denmark, Sweden, and Norway), would be—

For the Netherlands—

At Fl. 12·15c. = £1 it would pay us to draw gold from Amsterdam.

At Fl. 12·10c. = £1 there is par.

At Fl. 12·04c. = £1 it would pay Amsterdam to draw gold from London.

For the Scandinavian Union—

At Kr. 18·23 ore = £1 it would pay us to take gold from Copenhagen, Christiania, or Stockholm.

At Kr. 18·16 ore = £1 there is par.

At Kr. 18·07 ore = £1 it would pay us to send gold to Copenhagen, Christiania, or Stockholm.

Countries adhering to the Latin Union follow more or less the lead of France; the National Bank of Belgium, for instance,

before the war usually bought gold on the same terms as the Bank of France, and doubtless will do so in the future. Nevertheless, for exchange purposes, France may be said to represent the whole of the Latin Union and the countries in the South of Europe, and while theoretically we may take their specie points to be the same as those of France, in practice the actual rates at which gold will enter or leave their shores ultimately depends on the rates of exchange produced by cross dealings in bills of exchange between Paris and the respective centres—arbitrage, as it is called in exchange circles, concerning which we shall have more to say at a later stage in this book. For the rest, we may say that the receipt and despatching of gold from and to other countries, like Portugal, centres in South America, and other distant States, is of no practical importance.

CHAPTER V

FLUCTUATIONS in the exchanges—Principal conditions which cause exchanges to move in favour of or against a country.

BY this time the student of exchange will probably be fully persuaded that he knows all about foreign exchange, and will be anxious to get on to the practical work, but without in the least wishing to make the subject as gloomy as a ruined workhouse on a foggy night, it is necessary to try his patience a little further. There is little use in our knowing what are the extreme limits of exchange unless we also know what it is that causes exchange to swing backwards and forwards to these points, and in the hope that the whole business will soon be as plain as a row of pins to the budding exchange dealer, we will now pursue our investigation a step further and deal with the fluctuations in exchange and their causes.

The upper limit of exchange is, as we have seen, par, plus the cost of transmitting gold; the lower limit, par, minus the cost of transmitting gold. Now, what causes exchange to move within these limits? It will be fairly obvious to the reader of these pages that the primary causes will be the demand for and supply of bills of exchange. Foreign trade is mainly responsible for the drawing of bills of exchange, consequently, it is to trade conditions that we have to look for one of our exchange influences. Foreign trade is, in fact, the prime factor in exchange fluctuations, but, as we shall see, there are a good many component factors, which, though they are all part and parcel of that great fabric bound up in those two little words, imports and exports, do not immediately force themselves upon the notice of the casual reader of the trade statistics of a country. There is another great factor which in its bearing on the exchange position of a country is not less important than trade conditions, that

is the condition of the currency of the country. Worn and debased currency, a greater volume of currency tokens than is called for by trade requirements or the internal currency needs of a country, unrestricted issues of notes, or the issue of notes without a proper metallic backing, lack of control over the minting of subsidiary coinage, adherence wholly or in part to a silver instead of a gold standard, all these have a bearing more or less direct on the exchange situation of the principal countries of the world. We may summarize the matter by stating that exchange fluctuations fall principally under two main headings, viz., those arising from trade conditions; those emanating from the state of the currency.

From the following statement it will be seen that closely related to trade conditions are those which, while not so apparent to the newspaper coteries whose privilege it is to peruse and to criticize the periodical volumes of Government trade statistics, have, nevertheless, a close relationship with trade in their effect upon the state of exchange: we refer to the Invisible Imports and Exports.

Our analysis of the various influences may now be studied under their separate headings, as shown on p. 41.

We might almost call this a debit and credit statement, since on the one side are shown those influences which cause exchange to move against us and lessen the value of our currency abroad, and on the other side we have what are in effect our assets in exchange, that is, those items which make for the betterment of our exchange position—in other words, the appreciation in the value of our currency on foreign markets.

Let us take the items seriatim, dealing first with the debit side, which indicates those conditions which turn exchange against us.

The trade influences are, as will be seen, those which affect the demand for and supply of bills of exchange. The principal item here is the import of goods. Heavy imports, whether of goods or anything else, will tend to turn exchange against a country unless exports are on a correspondingly high scale, especially if the imports last for any lengthy period

Conditions which Cause Rates of Exchange to Move Against a Country.	Conditions which Cause Rates of Exchange to Move in Favour of a Country.
Trade conditions which affect the demand for and supply of bills.	Trade conditions which affect the demand for and supply of bills.
Heavy imports of goods and commodities. (Influx of bills drawn on the country.)	Heavy exports of goods and commodities. (Efflux of bills drawn on other countries.)
OTHER INFLUENCES.	OTHER INFLUENCES.
Invisible Imports.	*Invisible Exports.*
Imports of foreign securities. Flotation of foreign loans. Freight payments for space in foreign vessels. Ship-masters' drawings.	Exports of dividends due on foreign securities for collection in foreign country. Exports of coupons on foreign loans. Service of foreign loans. Export of the home country's securities to foreign countries. Earnings of our mercantile marine.
Banking Influences.	*Banking Influences.*
Cover for sales of bankers' bills of exchange. Payments to foreign residents abroad; payments to soldiers and sailors serving abroad. Payments to foreign bankers against bills of exchange drawn abroad under letters of credit sold in the home country. Telegraphic drawings by banks in foreign countries.	Covering by foreign bankers of bills drawn by them under letters of credit. Payments to remittance men. Telegraphic transfers of funds by foreign countries. Remittance of cover for drafts sold.
Arbitrage operations.	Arbitrage operations.
Currency Influences.	*Currency Influences.*
Direct influence of the state of the currency — debased currency. Indirect influence: increase in volume of currency, over-issue of paper currency.	Adoption of a full gold standard: return to a full gold standard in a country in which gold payments have been temporarily suspended.

of time. Imports have to be paid for, and with every batch of imports there will enter the country numerous bills of exchange drawn on the country by the foreign exporters, who are claiming payment for their wares. It does not at all follow that every foreign exporter will draw bills from the foreign centre on the country which is importing; in many cases the importer will be required to remit to his creditor, the foreign exporter. "But," says our wily reader, "in the one case you have a bill coming into the country, in the other the bill goes out of the country." Granted, but we are assuming that the bill which comes into the country is a claim by the foreign creditor to so much of our gold. The merchant abroad who sends his wares to Great Britain does not know, nor does he care, whether any goods go out in exchange; he obtains payment through the medium of this ubiquitous piece of paper, this bill of exchange, which does not necessarily imply an export of gold, but all the same it gives the holder the power of withdrawing gold from this country if he so desire. There is direct evidence of this in normal times. Exchange between London and New York in the autumn is often against London; the reason is that we are then heavily importing wheat and cotton from the States, and often gold has to be sent to bring exchange back to a workable rate.

In the second case, you are sending something tangible out of the country, but in paying your foreign debt you really send your creditor an instrument which gives him the right to have paid to him a certain amount of gold.

Having anticipated the reader's objection about the effect of these bills, we may proceed. We now come to those items conveniently grouped under the chief heading "Other Influences." The first of these so-called other influences is found under a sub-heading, "Invisible Imports." Here we come to grips with a problem which no one likes; the invisible is always elusive, and people don't seem to get to grips with it. Invisible imports comprise numerous things which affect the foreign exchange, but yet are not to be found as tangible

evidence of our, or, indeed, of any country's indebtedness in the Board of Trade returns, or in trade statistics of any kind. We know of no reason why many of the articles should not find a more or less prominent position in the statistics, although to be sure some of them would be very difficult to place, and having been placed by Government officials, might be even more difficult to locate!

These invisible influences form the regular *pons asinorum* for casual students of exchange, but a little reflection and examination will show us that they are fairly easy to trace.

Imports of foreign securities as a start need not be difficult of comprehension. Take as an example the enormous wads of railway share certificates which used to arrive in this country from America. America wanted money to build railways or to erect vast factories, so she proceeded to design and to print numerous highly coloured and otherwise artistic pieces of paper about a foot square, sent them to London, and in return for these all sorts of people who expected a higher return on their money than, say, Consols were able to produce, paid over their savings, became the proud possessors of these share warrants, and complacently waited for their dividends. Thus we imported from the United States paper records of proprietorship in dollar undertakings, and in return sent our hard-earned cash back across the Atlantic to assist in the development of another country's industries. The importation of these securities had a "bear" effect on our exchange market with America, that is, turned exchange in favour of New York and against London.

The flotation of foreign loans in, say, London, is somewhat similarly explained. We contract with a foreign State, no matter whether it be with Timbuctoo, China, or any other far-away land, to raise a loan in London for so many millions sterling. When the money has been subscribed by the ever credulous and trusting public, the time comes for us to place the money at the disposal of the borrowing country. We are, under the terms of our contract, heavily indebted to the other State for the time being; we are obliged to send so

much of our capital out of the country, and exchange turns against us and in favour of the borrowing country, because we are the debtors who have to make a settlement of our indebtedness; consequently, while the money is in process of being remitted, exchange is unfavourable. What we have done in effect is, to import thousands of the foreign nation's paper promises to pay given amounts at some far distant date; we have to make payment for this in the same way as if we had imported tea, sugar, wine, or any other luxury, and the effect on exchange is the same in all cases.

In both instances, that of the importation of foreign securities and the flotation on the home market of foreign loans, there is a redeeming feature in the shape of the favourable influence on exchange when the interest payments in the shape of dividend warrants or coupons are due, as we shall see when we come to consider the causes which force exchanges in favour of the country.

The influence on exchange of this financing of foreign countries, or exportation of capital, as some call it, has often been the cause of uneasiness to Government officials and budding politicians, although we are not sure that they have more than an inkling of its real effect. Thus, in February, 1912, in the Prussian Lower House, we find one, Rahardt, putting the following question to the assembly—

"A number of large banks have applied to the Minister of Commerce for permission to invest in an issue of Marks 48,000,000 of 4½% bonds of the Anatolian Railway Company. I ask the Minister what he intends to do to prevent the exportation of German money. . . . Are we to assist a foreign nation with German money at the expense of our own country?"

This foreign deputy seems to have perceived that in some indefinable way his country would suffer from lending this amount of money; whether he perceived the influence it was likely to exert on exchange is a moot point. It is also questionable whether some countries, in making conditions in the loan contracts requiring the borrowing nations to spend part

of the proceeds of the loan in the lending country in purchase of commodities such as locomotives, railroad materials, etc., see more than the chance to increase their exports at the expense of the borrowers, yet any such stipulation resulting in the retention of part of the money in the lending country, offsets to the extent of the cost of the materials, the adverse effect on exchange caused by the remittance of the loan proceeds, in addition to helping to cancel the balance of indebtedness against the country.

Freight Payments for space in foreign-owned vessels form another of those indirect influences on exchange which are not clearly visible. The earnings of these foreign vessels are, we may assume, taken back to the country from which the ships emanate, consequently the amounts we pay for shipping goods in their bottoms represent so much capital going out of the country, and to that extent is a condition which helps to turn exchange against us.

Ship Masters' Drawings represent the expense for coaling, re-victualling, and other incidental charges which fall upon ships when calling at foreign ports. For instance, suppose a ship homeward bound from South Africa be forced to put in to Las Palmas for coal, the captain will, we may imagine, be empowered to purchase his coal from some firm or other there, but the supplier of fuel will naturally want his money, so our friend the captain will go to one of the banks in Las Palmas, arrange with them to purchase his bill of exchange which he has drawn on the owners of the steamer in London, and with the money received will pay for the coal. Here, then, is a debt incurred and due by London. The banker remits the bill of exchange to his London Agent, and when it arrives the latter presents it for acceptance or payment, as the case may be, and in due course the proceeds are in the hands of the Las Palmas banker's agent for remittance to that centre if required. The instrument is a claim upon our gold; it is a debt due by us to a foreign country, and to that extent exercises a potential influence on exchange.

The Banking Influences are fairly numerous. The first is

summed up in that mysterious phrase, "Cover for Sales of Bankers' Bills of Exchange," which, like the writing on the wall that puzzled Belshazzar, the last of the Chaldean Kings of Babylon, in the days of Daniel, requires to be interpreted. "Cover" is simply a word used by bankers signifying that when they have drawn a bill of exchange on a correspondent they must send, or cause to be sent, to that correspondent, sufficient money in the currency of the country upon which the bill is drawn, to enable him to pay the bill when presented for payment, the vital necessity being that the funds must be in the hands of the correspondent before the bill reaches him. Now, if you could by a little persuasion get your banker to explain all about this he would probably tell you that the rate at which he sells paper known as "bankers' drafts" depends on the rate of exchange at which he can cover, that is, provide the money to meet them in the foreign centre. He might also tell you that there are various ways of doing this, the principal consideration with him being the comparative economy in the method employed—he chooses the cheapest way to do it. Say he has sold bills in London on New York. He may buy bills in the Argentine, send them to New York for encashment, and instruct his agent to place the proceeds to his credit in the New York Bank, or he may work what is called a three-cornered transaction: he may buy bills in Chile drawn on the Argentine and send the funds in that roundabout way to New York. Finally, as a last resort, he might have to send gold from London, it all depends on the relative cost of the various operations. To sum up, then, the bankers have sold bills on other countries, they have got to provide the money to pay for them, and whether they ask their correspondents abroad to draw on them in London, or whether they send the wherewithal from London to meet their sales, they have got to provide this cover, which it will be recognized must affect our exchange adversely.

Payment to Foreign Residents Abroad usually covers a multitude of transactions, from the sending of money for the upkeep of under-paid Consuls abroad to the niggardly

remittances by the sad father to his prodigal son in a far-off country. They all represent money going out of the country, and, as such, exercise an influence upon exchanges more or less important, according to the aggregate sum of the remittances.

Payments to soldiers and sailors serving abroad come under the same category, though this influence may be and is to some extent offset by the allotments of pay made by these worthy fellows to their dependents at home. Take the soldiers serving in France during the Great War. Many of them from time to time sent home French notes, mostly of the twenty-franc denomination, to their wives in Great Britain, the effect of one of such notes may be infinitesimal, but in the aggregate they must have counteracted to an appreciable extent the effect on exchange caused by our having to provide payment for our soldiers in France.

The Payment of Bills of Exchange drawn under Letters of Credit is another important feature. Letters of credit may be put roughly into two great classes, first, those which authorize the drawing of cheques or demand bills on the home country; secondly, those which authorize the drawing of bills of exchange abroad on London firms or bankers. The former are what are known as Travellers' Letters of Credit, the latter comprise mostly those credits which have shipping documents or other securities attached. In each case a cheque or bill of exchange eventually comes from abroad; in the hands of the foreign banker it is a claim over so much gold, and with any large amount of such drawings, exchange will tend to turn against the country which has to meet the bills. We also include under this heading those Circular Notes with which globe-trotters used to be so fond of furnishing themselves when they departed for warmer climes.

Telegraphic Drawings by Banks in Foreign Countries are apt to be an awkward element in creating an adverse exchange for the country which has to meet the drawings, for the simple reason that they have to be met in such a short space

of time. Say there are a number of Tom Browns and Peter Jones's enjoying themselves in a foreign country, and that the said gentlemen want money urgently; or, to take another case, a number of commercial gentlemen who see a chance to make profitable speculations abroad, they have funds at their credit in London; over the water they walk into the office of a foreign banker abroad, he may or may not know them; they produce evidence of England's indebtedness to them; arrange to pay for the cost of a telegram to London somewhat in the following form: "Remit by telegraphic transfer for the credit of Tom Jones £10,000." As soon as the banker here receives this telegram and has de-coded it, if everything is in order, he has to make arrangements to pay money through his agents in the foreign country. It will be readily perceived, then, that if such drawings go on to any extent, calls may very soon amount to millions of pounds sterling, and exchange will very soon swing round in favour of the country to which payments are to be made.

Arbitrage operations are closely allied to the influences we have just examined. Bankers, brokers, and a hundred and one other speculators may take it into their heads to have a little flutter on exchange; it may suit them to do this in a roundabout way. They may find it profitable to buy bills in a number of other countries, and eventually, when payment has to be made, will instruct their correspondents to draw for the cost on London. The business is also constantly carried out by telegraph; when profit is likely to be made by taking prompt advantage of favourable rates the arbitrage dealer will instruct his correspondents to sell and to draw on him for the cost, and the cumulative effect of such drawings soon sets exchange moving adversely. It does not follow that such operations will always be undertaken direct; sometimes there are slight differences in exchange between several countries, and it may be profitable to undertake a whole series of operations through various centres, and in these cases the ultimate effect may be spread over the exchanges of more than one centre.

Currency influences are always important: they are both direct and indirect. The direct influence would be more plainly seen where a nation alters the bullion content of its currency unit. Suppose, for example, you had 1,000 gold dollars of a known weight and fineness circulating in a country, and that for some reason or other those dollars were withdrawn from circulation and replaced by lighter coins, there would be a direct effect on exchange; other countries trading with you would offer less of their currency in exchange for your currency, for the very simple reason that your coins contain less of the valuable metal. An influence, not quite so direct, perhaps, seen more often in the exchange with countries like China, which pin their faith to a fluctuating silver standard and are, therefore, bound to be constantly manipulating their currency and exchange to meet the variations in the gold price of silver bullion. We find the currency of those countries regarded unfavourably by outside nations; their currency is treated as a commodity, and in settlement of their indebtedness they are obliged time after time to sell silver bullion in the same way as any other commodity is sold, and with the gold they receive in payment have to pay their way. Then, with debased coinage the value is always unreliable, whether of silver or of gold; it may pass current in the country of origin, but is no good for purposes of paying outside debts in other lands. The worst of it, too, is that the inferior or debased coins drive out any good money that may be in circulation, and that is the case, not only with China, where full-weight dollars are from time to time melted down and exported, but also with some of the South American States. The currency of Haiti, for instance, is often in an extremely bad way, and exchange constantly against them. There the gourde of 100 cents is the currency unit; it is supposed to be the equivalent of an American gold dollar, but owing to depreciation and consequent exportation of the silver coins, all that the gourde is worth is about 28 cents, that is, 3·50 gourdes are required in exchange for one dollar.

Where the volume of currency is increased beyond the needs of the people, or large issues of paper currency are put into circulation, the influence is indirect, since it reacts on commodities, prices rise, which is another way of saying that the currency depreciates; the country thereupon becomes a good country for foreigners to export to, not only do they benefit by exchange being in their favour, but they also realize the higher prices ruling for the commodities they ship to the country with the depreciated currency and adverse exchange.

In connection with these currency influences, one would have thought that marrying and giving in marriage would have been the last thing in the world to have an effect on exchange, yet it is a curious fact that the Indian marriage season, which usually falls in May of each year, is responsible for one of these exchange influences. Just as the Indian exports of wheat and grain form a seasonal influence which turns exchange in favour of India, so the Indian marriages may be said to form a seasonal influence to turn exchange against India. It arises in this manner. By Hindu caste custom it is necessary for the bridegroom, or his father, to give gold and silver ornaments to the bride at the time of the marriage. The ornaments are called "Stree-dhan"—the woman's property. They are in the nature of a marriage settlement, and are the absolute property of the woman, who is said to preserve them with great care. Added to all this, it is customary to give a great Tomasha (feast) to the thousand and one relatives and followers, all of which represents a heavy expenditure in silver. Eastern exchange dealers, bankers, and brokers have found by experience that the marriage season calls for a vast amount of extra currency, mostly silver, and it is found to be absolutely necessary to be well prepared for this seasonal demand. Large quantities of silver and even gold are imported in readiness for the marriages, and these heavy imports naturally tend to turn exchange against India and in favour of the exporting country, generally England, sometimes China.

It would be rather interesting to know what is the

cumulative influence of the giving of gold and silver wedding presents in England, but we are afraid it is impossible to trace the effect, and in any case the trade requirements for the precious metals in England are relatively unimportant as far as exchange is concerned.

We now arrive at what may be called the credit side of the account, namely, those influences which cause rates of exchange to move in favour of a country. The first of these we find in the trade conditions which affect the demand for and supply of bills of exchange. Here we get bills drawn on other countries, and the larger the exports the greater will be the number and value of these bills so drawn. They represent a claim on the gold of other countries, and as such, serve to turn exchange in our favour. It is often argued by the casual enquirer, and he it is who is always the most difficult person to convince, that many shippers, when drawing bills of exchange, present the bills with shipping documents to their bankers; the banker, it is said, buys the bill, and because he hands over the money to the exporter on the spot in the exporting country, that is the Alpha and Omega of the transaction as far as the exchanges are concerned. It is maintained that the money or the gold represented by the bill of exchange does not in such circumstances come into the country: it is already there, argues our friend. We agree that so far as he, the exporter, is concerned, that he does sometimes receive his money as soon as his goods are ready for shipment, but what about the poor banker, is he out of pocket over the transaction? No! bankers are not philanthropists, they are not likely to make a foreign country a present of the goods exported, consequently, it is merely a transfer of foreign indebtedness from the exporter to the banker. In the hands of the banker this instrument represents a claim to gold or its equivalent in the foreign country, and if the banker so desire, he is entitled to bring that gold home to the mother country. In practice, he will probably utilize the money he receives in payment for the exports to purchase other bills in the foreign country, and so make an additional

profit on exchange, but that is a horse of another colour, and it does not follow that in all cases the proceeds of the bill he has purchased from the exporter on this side will be so utilized.

"Invisible Exports" take pride of place among "other influences," and with these important items hidden from the busy man of affairs we find "Exports of Dividends due on Foreign Securities." The dividends in question represent the payments of interest due on the various stocks and shares issued by the foreign country, but held in London or other parts of Great Britain. Half-yearly, or even quarterly, we have numerous payments due to us on these investments, and the greater the amount of the securities so held, the greater will be the effect on exchange when the time arrives for the foreign undertakings to pay the interest due to the holders. Frequently, payments of this nature are in the shape of dividend warrants in dollars, say, American; the holders, we may assume, send them to their bankers for collection, the banker sends them across the water for payment, and in due course the amount is transferred to the credit of his client here. It may be easily imagined that any appreciable amount of such dividend warrants in the hands of a banker gives him a claim to receive the equivalent in gold in the foreign country, and in this respect they form a useful item in the turning of the exchange in favour of the country sending them for collection and payment.

The Export of Coupons on Foreign Loans has a similar influence. Coupons are an ever-recurring item in our "invisible exports," only in this case they are much more easily traceable if anyone cares to take due cognizance of them, and as a matter of fact many exchange dealers do make it their business to know something about them. With the Chinese and Japanese loans, for instance, interest often falls due half-yearly; money has to be in the hands of London bankers who issued the loans in time to meet the coupons which will be presented for payment by holders of the bonds. The dates when this takes place are well known to exchange

operators, and they are thus able to get a rough insight into the probable course of exchange, and, let us hope, profit by their knowledge.

The Interest Payments on these foreign loans exercise a marked influence on exchange, and in concerning themselves with the date of paying the coupons—known as the service of the loans—the banks are really of immense benefit to the country. Theoretically, Great Britain is often in the position of showing an unfavourable balance of trade, that is, as judged by the visible imports and exports, and one of the reasons we are able to go on doing this is because we have these large amounts payable to us year after year; they more than offset the unfavourable balance.

Eventually, the principal of the loans falls due to be repaid by the borrowers, and here we really export the bonds and the borrowing country has to send their value to us. The student will observe that nearly all the loans are what are known as "Gold Loans"; if value in terms of gold is originally lent, then in terms of gold will the value of the loan have to be repaid.

The export of the home country's securities may now be well understood. We have the various War Loans as an example. People all over the world were so constant in the belief of the ultimate outcome of the Great War that they willingly, we may even say, eagerly, subscribed to the various loans. In fact, we exported the bonds or certificates and the foreign countries sent gold in exchange, and these exports, invisible as they were, obviously influenced exchange in our favour. For another example, we may take the way exchange between this country and America was kept on a workable basis during the war. People both lent and sold American securities to the British Government. In the hands of the British Government, these represented a claim on America; that is, on her gold, and they were utilized to stabilize exchange. Early in 1917 it was estimated that America had bought back her own securities to the extent of over four hundred million pounds sterling, and by selling them, we prevented

the American exchange from becoming too unfavourable to London. In regard to these sales of American securities, it is important to note that the effect is a diminution of "invisible exports," for the interest on the capital sum in exchange for the coupons or interest warrants no longer comes to us from the United States, but accrues in America, and as we have parted with these securities, it is clear that the amount of interest we shall henceforth have to receive from the United States must be considerably reduced as compared with, say, the year 1913.

Curiously enough, the fact that the issue of these internal loans has a favourable influence on exchange in the issuing country, was corroborated while the writer was preparing this chapter for publication. At the end of November, 1918, the Dutch Government issued an internal loan for 350 million florins, and as soon as the subscription list for the loan was opened exchange moved in favour of Holland and against London. On the face of it, the effect of the issue of the loan on exchange was a little puzzling; people could not see why, its being an internal loan, exchange should be affected at all. The reason was that Dutch capitalists with balances in London withdrew them in order to invest the funds in their national loan, and as the withdrawals were continuous, the rate of exchange soon moved adversely to London.

The earnings of our Mercantile Marine are an important item in the list of invisible exports which exercises a favourable influence on our exchange with foreign countries. The actual return from our ships is not only that received for carrying our own imports and exports, but there are also the freight payments we receive for carriage of goods between foreign countries and between British Colonies. The income accruing from these services, like all the profits which arise from our indirect trade, must amount to very considerable figures, and these, added to the earnings of our mercantile fleet, form an "invisible export" which has no mean influence over the exchange rates between Great Britain and other countries.

The covering by foreign bankers of bills drawn by them

under letters of credit comes under the banking influences which are not clearly visible in their effect on exchange, but the influence is important. Foreign bankers under arrangements with London and Colonial Banks often issue letters of credit to their clients who may be travelling either to England or some other country, and the bills when drawn must be provided for, that is to say, the banker who has issued these letters of credit must be prepared to meet the bills which from time to time come forward from his correspondents, and in many cases he remits the money direct to England for this purpose.

Then there is another case similar in form and similar in its favourable influence on the exchange of the country. It arises in this manner: a Colonial bank we will suppose has a branch in London, it has also many branches and agencies abroad. Frequently other foreign banks, say in Europe, are asked by their customers to sell bills on certain of these centres in which the British Colonial bank has a branch; the foreign bank will draw the bill on the Colonial bank's foreign branch, sell it to his client, and at the same time advise the bank in London that it has done so. Together with the advice of this drawing will be sent cover for the bill, or instructions to draw for the amount.

Telegraphic transfers of funds by foreign countries operate in the reverse direction from telegraphic drawings on us: they serve to turn exchange in our favour.

Arbitrage operations have a favourable influence on exchange when they are such as to result in the transfer of funds to this country. Sometimes as the result of a long run of speculation there is a continuous stream of remittances to London, and it is easy to see the effect on exchange if the movement of funds goes on for a long period.

Under the heading of currency influences which make for the betterment of the exchange position of a country we refer to the adoption of a full gold standard. The effect there is seen more plainly in the case of countries hitherto on, say, a silver basis, which decide to put their currency house

in order and to place their faith in a gold currency instead of an unstable silver standard. Several countries in our times have accomplished this feat, and the result has been an improvement all round in the exchange value of their currency: instead of exchange being pulled first this way, then that way by the fluctuations in the price of the white metal, the value remains subject only to the ordinary rules of supply and demand, and matters are no longer complicated by the additional variable factor—the price of silver. Where a country returns to a full gold standard after a period of temporary suspension of gold payments, the effect is all to the good. Legal tender currency has depreciated during the restriction of gold, the depreciation is reflected by exchange, and as gold again becomes available freely for export where wanted to settle international indebtedness, exchanges return to their normal figure and imports cost us less, because we have to surrender so much less of our currency in payment.

The various items we have examined by no means exhaust the multifarious influences on exchange; there are many others, all bound up with invisible imports and exports; the income derived from bankers' and traders' commissions, insurance premiums, and so on, all exercise an influence more or less direct on exchange, but we have given the reader we believe sufficient food for reflection, and if he cares to pursue this part of the subject, he will doubtless find the fluctuations in exchange, their causes and effects, to be not the least interesting section of an absorbing study.

CHAPTER VI

FLUCTUATIONS in the Exchanges—In which the reader is given an insight into the more practical side of foreign exchange, as prepared for him by the City editors of the newspapers—The "Foreign Exchange Quotations," the "Course of Exchange,"—The origin of the City article.

THE City Editor of our great newspapers is nowadays a person of some importance in the City of London, and before examining his daily contribution to the wealth of literature which is so regularly served up with our morning dish of eggs, we will take a peep beneath the mystic shades of antiquity to see what his doings were before he came forth into the glare of the twentieth century.

Newspapers had been circulating a good many years before it occurred to an enterprising editor to cater for the commercial world, and the City article as a distinctive feature of the daily papers dates back no further than about the year 1823; it is thus less than 100 years old. It is doubtful with whom the idea originated; some people claim that *The Times* was the first newspaper to publish regularly the City article; others give the credit for the innovation to the *Herald*, a newspaper which enjoyed much popularity in the early fifties, but which for some reason or other has long since disappeared. Still, whichever paper may be entitled to the praise for commencing so useful a feature of the morning newspaper, the fact remains that its lead was soon followed by all the other journals of the day, and from the year 1824 down to the present time the public has been favoured with a regular supply of City news in concrete form. Prior to that date the editor of the "Thunderer" and his contemporaries had been content to publish isolated paragraphs giving such items of information concerning the world of commerce as they thought to be of general interest, but no very prominent position was given to this news until the

more important era which followed on the close of the Napoleonic wars.

We do, it is true, find in the papers published during 1809 and 1810 regular references to the price of Consols, and other important securities then favoured by the investing class, but the list was rather an haphazard one, furnished by some stockbroker or other, who for this service was allowed to have his name and address printed at the bottom of the list; he thus got a free advertisement.

As interest in these announcements increased, the enterprising editors gave more space to City items, and when in 1817 the craze for forming joint-stock companies started, more and more attention had to be given to the kaleidoscopic changes in the metropolis. A craze for the wildest of wild speculation set in; it was all duly chronicled by the editors in their City article; a panic looked imminent; the City editor, in the fullness of the knowledge he had gleaned from the markets, foretold the inevitable day of reckoning—his comments were given in that terse, nervous English which is so marked a feature of the City article of our time. With all the due solemnity of the prophet, readers were warned to cut their losses and to get rid of their commitments before the crash came. People commenced to get uneasy; some took the advice tendered by the editor and sold their stocks and shares; others, like the incredulous folk in Sodom and Gomorrah, ignored the advice so freely given, and were shortly afterwards swallowed up in the black ruin that followed the stoppage of banks and the failure of many so-called respectable business houses. These days were a time of much distress and much heart-burning, and there is little doubt that the Press, or rather the City part of it, was the means of purifying the atmosphere of City life. Fearless exposure was the order of the day, and there were not wanting brokers who complained that the Press had ruined their markets; but the louder they were in their complaints against the prejudices alleged to be encouraged by the newspapers, the quicker was the public to realize the real position of

affairs. As one of the old writers of that period remarks: "As the medicine operated, so the disease began to disappear," and thus was the power of the City Press developed in all its fullness.

The City editors began to extend their contributions; they were unflinching in their criticism of those financiers who merited their censure, and it began to dawn upon the dealers in money and all that pertains to it, that a new power had sprung up; they saw that the power of the Press was commencing to exercise something in the nature of an occult power over the commerce of the country, and such was the influence of the high-class newspaper of the time, that they feared to incur its displeasure by shady practices. The fearlessness with which the writers of the City article exposed anything tainted with fraud or questionable dealing, the promptness with which they laid bare to the public the designs of roguish speculators, and the ready explanations they gave of the failures of bubble companies or undertakings, made them a power to be reckoned with, and the heartless promotors of bogus or shady enterprises commenced to be afraid of the lynx-eye of the newspaper's City representative. It was high time, too, for one reads with amazement the list of companies published by the newspapers during the years 1825–26. It is a record of infamy, plunder, and sacrifice, of fraud and cajolery; it reveals a gullibility on the part of the public comparable with that which causes some of the African and other native races to barter valuable commodities for a row or two of gaudy beads. In the record we find included every description of association under the sun; the list goes from the sublime to the ridiculous; hundreds of projects are mentioned, ranging from fantastic proposals for the extension of the principles of life assurance to the formation of a patent washing company which it was suggested should be established on the Isle of Dogs.

There have been many other crises and panics since that of 1825–26, and the hand of the City editor has lost none of its cunning in describing them. Those of us who read the

City article during the sad and exciting days of August, 1914, and followed it day by day down to the joyful days of November, 1918, were astonished at the ease, the skill, and the erudition displayed by the City scribes: they treated us to a perfect feast of literature, ranging from the dry-as-dust dissertations on economics to the exhilarating joys of higher finance. They told us how and how not to save money: they even ventured into the realms of prophecy—when it was safe to do so—and, taking their cue from the trend of the foreign exchanges, were able to point to signs of the coming of peace.

We thus see why it is that the City article is read in commercial circles with so much interest and even enjoyment. The perusal of the City news is, however, becoming much more important to a wider circle of the reading public. At one time, the Jones's, the Smith's, and the Robinson's were only interested in the movements in the price of the shares they held in City tea-shops, far-away rubber plantations, or in gold mines in South Africa or Australia. The war has changed all that. We still watch our shares rising or falling in value, but our City editor having taken upon himself to initiate us into the darker mysteries of the appreciation and depreciation of money, we have commenced to turn to his writings to see how the quotation for the pound sterling is progressing in other countries, and step by step the columns on the City page are becoming something more than a closed book to the anaemic denizens of our over-crowded railway carriages. The truth is, the men and women of to-day who wish to be something more than mere nonentities, can no longer afford to ignore the City news; they are expected to be able to discuss it with the men of affairs, consequently, the City article has not only progressed but has advanced in favour; it is not only a complete guide to the commercial business of the metropolis, it is also a reliable record of the happenings in monetary circles all over the world, and among the many items which are furnished daily for our edification, we find the list of foreign exchange rates—a few columns of

figures which, at the first glance, look like the proverbial Chinese puzzle. Here is a specimen, taken from the *Morning Post* of 6th December, 1918. We print the list exactly as given in the paper, and, as will be observed, it contains the quotations for the two previous days, to wit, 5th December and 4th December—

FOREIGN EXCHANGES

	Dec. 5th.	*Dec. 4th.*
Paris cheques (Bk. rate 5%) .	25·97½–25·98½	25·97½–25·98½
Amsterdam cheq. (Bk. rate 4%).	11·20 –11·23	11·25 –11·27
Italy sight (Bank rate 5%) .	30·25 –30·37½	30·25 –30·37½
Madrid, sight (Bk. rate 4½%) .	23·93 –23·96	23·92 –23·96
Switzerland (Bank rate 4½%) .	23·35 –23·40	23·30 –23·35
Christiania (Bank rate 6%) .	17·05 –17·10	17·05 –17·10
Stockholm (Bank rate 7%) .	16·53 –16·58	16·55 –16·60
Copenhagen (Bank rate 5%) .	17·75 –17·80	17·75 –17·80
Lisbon, sight (Bk. rate 5½%) .	32–33d	32–33d
Petrograd, sight . . .	—	—
Alexandria (Piastres to £) . .	97⅜	97⅜
Rio, 90 days (val. of milreis) .	13–13/16d	13⅞d
Buenos Aires (90 days) . .	52¼d	52¼d
do. T.T. . . .	51–1/16d–52–1/16d	51–52d
Valparaiso (val. paper peso) .	11–23/32d	11–13/16d
Montevideo (90 days) . .	61d	61d
Do. T.T. . . .	58¾–59¾d	58¾–59¾d
Lima	7¼ p.c. dis.	7¼ p.c. dis.
Bombay T.T. (Bk. rate 5%) .	1s/5–31/32d	1s/5–31/32d
Calcutta T.T. (Bk. rate 5%) .	1s/5–31/32d	1s/5–31/32d
Hong-Kong T.T. . . .	3s/4¼d	3s/4d
Shanghai T.T.	5s/2d	5s/2d
Singapore T.T.. . . .	2s/4⅛d	2s/4⅛d
Yokohama T.T. . . .	2s/2¾d	2s/2¾d
Montreal cable transfers[1] . .	4/82–4·82½	4/81¾–4·82¼
New York cable transfers[1] .	4·76⅜–4·76–7/16	4·76⅜–4·76–7/16
New York cheques[1] . . .	4·76⅞–4·77⅛	4·77⅛–4·77¼

We will now proceed to analyse this list in the hope that by the time we have done with it the table of the Foreign Exchanges will be shorn of half its terrors to the uncomplaining and diligent seeker after wisdom and understanding.

[1] These rates refer to London drawings.

The first quotation, Paris, represents the number of francs and centimes which will be given for one pound sterling on the day current, 5th December, 1918. To get the true perspective it is necessary to imagine yourself on the Paris market, and if you want to send pounds sterling to London, the rate in question is that at which a cheque drawn on a London bank will be sold in Paris. However, as the reader will note, there are here two rates, 25f. 97½c. and 25f. 98½c. These are buying and selling rates, and it is very necessary to distinguish between the two quotations. Take the first rate, 25·97½, suppose you are in London and want to pay a debt in Paris in francs, you would find that the Credit Lyonnais in London would be prepared to sell to you 25f. 97½c. for every pound sterling you handed over in London. If, on the other hand, a French correspondent has sent a cheque in francs to you in settlement of his debt, and you went to the same bank in London you would find that the banker would require you to surrender 25f. 98½c. for every pound sterling he pays to you. In other words, he will sell to you at 25f. 97½c., but when it comes to buying from you he wants you to give him a centime more (*i.e.*, 25f. 98½c.). Now, suppose you are in Paris, is there any difference? The French bank in, say, the Avenue de l'Opéra, has a number of cheques drawn on London banks in sterling, you have the francs. If you want to purchase one of these sterling cheques you will have to hand the banker 25 francs 98½ centimes for each pound sterling, but if you have sterling cheques in your possession, the bank in Paris will only be willing to give you 25f. 97½c. for each £1. There is thus a difference in the way the quotations appear in Paris and in London. To make it plainer, we will set out the figures—

Cheques—London on Paris 25·97½ sellers. 25·98½ buyers.
Cheques—Paris on London 25·97½ buyers. 25·98½ sellers.

In the first case it is just as if the bank said to you: "We will exchange francs into sterling for you, but you will have to surrender 25 francs 98½ centimes for each London cheque for £1 we hand over to you."

Or, again, "We will exchange sterling into francs just to oblige you, but we will only give you 25 francs 97½ cents for each cheque for £1 you hand over to us."

In the second case, the French banker in Paris may be assumed to reply to your offer: "Oh, yes! I will buy sterling cheques from you—I will give you 25 francs 97½ centimes per each £1 they represent."

For your part, you reply—

"I want to buy sterling cheques drawn on London."

"Very well," says the banker, "you must hand me 25 francs 98½ centimes for each £1."

The same principles apply in the case of Amsterdam and the other European centres down to and including Copenhagen. The Amsterdam rate is for cheques or bills payable on demand, that is, 11fl. 20c. per £1. Italy quotes in lire and centesimi to £1, but here we get a variation, the word "sight" is added, and, as the reader will readily perceive, it means the amount of Italian currency which is exchanged for £1 in the shape of a sight draft, that is a bill drawn on a bank and payable at sight, or, in other words, immediately on presentation. To all intents and purposes, therefore, it is exactly the same as a cheque, for they are both really demand bills. The Madrid quotation is for sight bills drawn in pesetas and centimos; Switzerland in francs and centimes; and the three Scandinavian centres, Christiania, Stockholm, and Copenhagen represent the number of kroner and ore per £1, all for sight bills.

The principal point to remember in dealing with these currencies quoted in foreign units to the pound sterling is that high rates are for us, and low rates against us. That is, as far as our country is concerned. If the rate is high, that is more francs and centimes, lire and centesimi, kroner and ore, and pesetas and centimos, are quoted per pound sterling, the rate is said to be in favour of Great Britain, and it means that the pound sterling has appreciated—it is worth more to these foreign countries quoting for it. If a small number of francs and centimes, etc., are being offered for our pound

sterling, the quotation is against Great Britain, and the pound sterling is said to be depreciating. This maxim, high rates are for us, low rates against us, has rather a different bearing when dealing in these currencies; just whether exchange is for or against you will naturally depend upon whether you are a buyer or a seller of foreign currency. If you are a buyer and the rate is high, obviously you will get a larger number of francs and centimes, or other foreign currency, in exchange for each pound sterling you part with. The boot is on the other foot if you happen to have the foreign currency to sell. In the latter case, as the seller has to give up so many more francs, etc., for each £1, the rate is adverse to him. Similarly, when the rate is low, it is against the buyer, because he receives so many less of the foreign units to each sovereign with which he parts, but if the operator be the seller of foreign currency, the low rate will be in his favour, because he is called upon to surrender so much less of the foreign currency in exchange for our unit of currency. As far as the individual is concerned, then, the question as to what is a high rate and what is a low rate, depends upon whether he be a buyer or a seller. Seemingly, it is all very paradoxical, but so common is the error of regarding a change in the rate to a lower figure in foreign currency as a decrease in price, and *vice versâ*, that some of the wits of the London market have composed little ditties to make the way plain for their clients. The writer calls to mind the following lines, which well illustrate these points—

It's neither Dutch nor Irish, and the man is not a liar,
When he declares that foreign rates are lower when they're higher.

This assertion that high rates are for us and low rates against us, is only true when we get foreign units to the pound sterling; where pence are quoted for the foreign units, it is necessary to re-state the rule. For example, in our list we get Lisbon given as 32–33d. This quotation is usually understood to be for the milreis; in exchange circles it is known to be pence per silver escudo, and it is the price at

which the banks in Lisbon were willing to sell sight bills on London on 5th December, 1918.' Here again the reader has to imagine he is in Portugal; he is supposed to be under the necessity of sending money to London; he goes to one of the banks in Lisbon, tells them what he desires, and asks what will be the rate at which he can effect exchange from Portuguese currency (*i.e.*, silver escudos) into British currency. On learning the rate, he will hand over to the bank one native coin for each 32d. he requires to settle his debt in London. So far, all is plain sailing. But when these pence rates fluctuate, how are we to regard them? The answer is, that low rates are for us, high rates against us, and for this reason. If you are buying the foreign unit, the more pence you have to pay for it, the worse will be the rate for you. If, on the other hand, the rate is low, the fewer will be the pence you will have to part with and the better will be the quotation for London. Here, again, however, the student must be careful to take into account that, as far as the individual is concerned, it all depends on whether he be the buyer or the seller. A low pence rate will suit the buyer all right, but it will be hard on the seller. On the contrary, a high pence rate will please the seller mightily, because he will get more pence for his foreign unit.

Petrograd is shown in blank. In normal times, the quotation is for so many roubles for £10 (generally about 95 roubles go to £10), but during the war so depreciated has the currency in Russia become through the continual watering of the currency by large issues of paper notes, that sometimes over 400 roubles have been offered for £10 sterling; and as these pages leave for the printers' hands, no less than 750 roubles are being quoted for £10 in some parts of Russia.

In the Russian exchange we revert to our former rule; high rates are for us, low against us, as the more roubles and kopecks we can get for a £10 Bank of England note the better it is for London, and the higher is the value of the pound sterling. The Alexandrian quotation is, as stated, for piastres to £1—here in our list, it is 97⅜ piastres to £1,

and the same rule holds good, viz., it will be more unfavourable to London if it goes down and more favourable if it goes up. The quotation is the middle rate quoted in Alexandria for pounds sterling to be sent to London by telegraphic transfer. That is to say, for every 97⅜ piastres you pay a bank in Alexandria the banker will pay to any person you name in London £1, the instructions to pay being sent to the bank's London correspondent by telegram.

Rio de Janeiro quotes its exchange in pence per milreis and expresses it in 90 days sight bills. The price, 13–13/16d. is that at which bills will be sold drawn on London in sterling, payable 93 days after they have been received in London (*i.e.*, sighted), the extra three days being days of grace allowed by English law, and if you were in Rio you would find that in exchange for each inconvertible paper milreis the bank or other exchange operator would hand you 13–13/16d. in English currency, only the bill for the latter would not be payable until 93 days after it reached England. This is another case in which, the unit being quoted in pence, low rates are for London, high rates against London.

After again referring to our list, we find the next exchange is that for Buenos Aires. Here we get two rates, the one for 90 days sight bills and the other for telegraphic transfers. The quotation for sterling expressed in 90 days sight bills is, as will be seen, in pence, and it represents the number of pence which will be given in exchange for one Argentine gold dollar, the bill of exchange sold by the bank or exchange broker being a bank draft, that is, a bill drawn on a London bank, payable 93 days after sight. The telegraphic transfer quotation—51-1/16d. - 52-1/16d.—is for sellers and buyers. The banks will sell sterling, that is, will sell 51–1/16d. for one Argentine gold dollar, and on payment of the dollars will immediately instruct their London branch by cable to pay over the sterling equivalent to the person designated by you. The second rate, 52–1/16d., is that at which the bank will buy from you. Suppose you were in Buenos Aires, you have a sum of money to your credit in London, the bank

will buy the right to receive it from you at 52-1/16d., that is to say, the banker wants one penny more per gold dollar than the rate at which he is willing to sell sterling to you.

A similar explanation fits the Montevideo rate, the first quotation is for bills drawn on and payable in London 93 days after sight, and is 61d. The second is the rate quoted for transferring sterling by telegraphic transfer from Uruguay to London. In 90 days bills the quotation is for bank drafts drawn on London and for each Uruguayan gold dollar paid in Montevideo, 61d. will be given in exchange. The telegraphic transfer rate is also in each case for pence per Uruguayan gold dollars in exchange for which sterling is paid in London.

The Lima rate is a little peculiar, and in it we hit upon one of those little idiosyncrasies which seem designed to worry the exchange student. "7¼ per cent. discount," without any further explanation, does not enlighten us much. Those who deal with Peru, however, will tell you that the quotation is that for our old friend the 90 days sight bill; it will be drawn on London, and in Lima for every Peruvian £100 paid over by the buyer to the banker, the latter will hand him a bill, drawn at 90 days sight on London for £107·5s. The Peruvian pound, commonly so called, is really the Libra, a gold piece equal to ten soles, which again is taken as the equivalent of one pound sterling, and from the way the rate is quoted it is plain that gold is at a premium in Peru of 7¼%.

The Bombay and the Calcutta rates are for telegraphic transfers, and for every rupee paid over to the bank in Bombay and Calcutta it will instruct its London branch to pay to a named person in that city 1s. 5-31/32d.

For transferring money in the reverse direction it costs about 1/32d. to 1/16d. per rupee more. For example, if you wanted to send money to your principals in Bombay, the banker would probably agree to instruct his branch there to pay so many rupees at, say, 1s. 6d. to 1s. 6-1/32d. per rupee.

The Hong-Kong and Shanghai quotations are capable of somewhat similar explanations. Take Hong-Kong, here the person desiring to remit sterling from Hong-Kong for payment in London, pays in Hong-Kong one dollar for each 3s. 4¼d. to be handed over in London after the cable has been received and de-coded. The Shanghai quotation is also for telegraphic transfers, the unit there being the tael, so to pay 5s. 2d. in London on the day in question, it costs one tael in Shanghai. Then the Singapore quotation is for transfer by telegram, and the currency unit is the Singapore dollar. The Yokohama rate is for Japanese yen, and in each case we get the sterling which will be paid in due course in London in exchange for one dollar, yen, etc., paid in the foreign country.

The Montreal rate is for Canadian dollars, and as the asterisk denotes, refers to London drawings, so for every £1 paid in London the bank will pay to any person you like to name $4·82 cents in Montreal, the remittance being made by cable transfer, which is nothing more nor less than our old friend the telegraphic transfer in a new guise. Cable transfers are exactly the same as telegraphic transfers.

The other rate—$4·82½—is that at which the bank will buy from you your right to dollars and cents in Montreal.

The New York rate is similarly explained, the quotation in this case being for American gold dollars, therefore for £1 you purchase the right to receive $4·76⅝ in New York, the order to make the payment being sent by telegram or cable, whichever the reader likes to call it. If you elect to take your money by cheque, the person to whom you send the cheque will receive half a cent more in New York for every pound sterling you pay in London, which is by way of a small compensation allowed by the bank which has had the use of your money for a longer time: in other words, it is interest.

It might be useful to mention that these quotations referring to London drawings are merely those which have come into force during the war. In general practice, the New York rates are those in force in New York, and the Montreal rates

are those in force in Montreal, not London, and possibly when peace conditions once more obtain we shall find the dealers—and the newspapers—reverting to the old practice of quoting the American rates and Canadian rates as given on the chief centres in those countries.

As a matter of fact, the real rates for London drawings are given separately in the newspapers under a heading called the "Course of Exchange," which we may now proceed to examine.

In market parlance this schedule of exchange rates is called the "On 'Change" table, and the quotations which it gives—those ruling in London, are not nearly so important as those embodied in the "Foreign Exchange" list, which quotes the equivalent of our currency in all the principal foreign centres. The Course of Exchange is published in the newspapers twice a week, on Wednesdays and Fridays, and the rates included are those at which business has actually been done on the preceding days, Tuesday and Thursday. On 'Change, Tuesday and Thursday are the two great days of the week, it is on these days that the full force of the mercantile interest, the financial interest, and the banking interest is felt and is in attendance in the grand old building in which the principal dealings take place—the Royal Exchange. Most people know the origin, some know the history of this stately edifice, and a few know for what purpose it was erected. Sir Thomas Gresham, who was one of the most successful and one of the most enterprising of London merchants in the time of Queen Elizabeth, caused it to be built for the convenience of his confrères in the City of London: he wished them to have a place in which to transact their business—a meeting place of which they all could be proud. Many changes have taken place since then, and the Royal Exchange has been altered again and again since it was destroyed by fire, and few of our forefathers, could they rise for a moment from the grave, would be able to recognize the beautiful building which now stands on the site of the first Exchange.

It is in the majestic hall, resplendent with its magnificent

panel pictures, that the banker rubs shoulders with the merchant, that the broker jostles the dealer, and the office-boy treads on the toes of the august senior clerks without fear of the consequences. In this democratic age such an institution as the Royal Exchange is rather a useful place; somehow or other it seems to be a place where all are equal, and if ever there was a spot in which the distinction of wealth is unknown, it is on 'Change. As an anonymous writer once put it: "The small jostle with the great, heedless of right or might, and the concerns of the one weigh as heavily as those of the other in the breasts of the individuals affected, and of those with whom they have dealings." The scene on 'Change when business is in full swing is always a sight worth witnessing, even to those who are regular habitués of its precincts, and the chance loiterer who happens to be strolling in the neighbourhood of the Royal Exchange might do worse than spend a few minutes in watching the lively antics of the sedate managers of banks and City houses.

The quotations in the Course of Exchange are those at which bills drawn on the various countries have been bought or sold, and at the close of the bargaining the records are prepared and handed to the Press for publication on the following day. The lists, as has been said, are published only twice a week, and the reason is that London, being the international monetary centre of the world, has more bills drawn upon her than she draws on other countries, consequently, dealers in foreign exchange are much more keenly interested in the rates ruling on foreign centres than they are concerned with those settled in London. The following list is that which appeared in *The Times* of 20th December, 1918, and shows the price current on the previous day. It will, perhaps, be useful to quote the words preceding the table. *The Times* City editor said—

"On 'Change rates on Belgium, Portugal, Holland, and Scandinavia moved in favour of this country. Spanish and Swiss currencies improved in value. The following rates were quoted—"

Amsterdam	Cable	11·16	11·21
Belgium	Cheque	27·25	27·50
Paris	Cable	25·96	25·98
,, three months		26·35	26·50
Switzerland	Cable	23·	23·10
,, three months		23·40	23·55
Genoa	Cable	30·25	30·37½
Spain	Cable	23·83	23·93
,, three months		46⅞	47⅞
Lisbon and Oporto	Cable	33¼	34¼
Copenhagen	Cable	17·58	17·68
Christiania	Cable	16·86	16·96
Stockholm	Cable	16·17	16·27

The first thing we have to bear in mind here is that the Course of Exchange records dealings *from London*, in contradistinction to the "Foreign Exchange" list, which expresses the rates in force in foreign centres for drawings *on London*. In the Course of Exchange, therefore, the rates for long-dated paper (three months' bills) are higher than those for short bills and telegraphic remittances. For each sovereign we get more florins and stivers, francs and centimes, etc., if we buy a bill payable three months hence than we do if we purchase a cheque or a cable transfer. Then, there are one or two ways in which this list differs from the "Foreign Exchange" list. The Amsterdam rate is that quoted for transferring money from London to Amsterdam, it is for florins and stivers to £1, not florins and cents, as in our other table. In this case, 20 stivers go to the florin, and if we compare this with the Amsterdam on London rate, in which 100 cents equal one florin, it will be plain that the stiver is equivalent to 5 cents. Why the exchange dealers stick to this old fashion and give the fractions of the florin (or guilder, as some of them still call it) in stivers, is beyond our comprehension, but while they continue the practice it will still be necessary for us to twist our brains round and when quoting the Dutch exchange from London, instead of saying £1 = florins 11·16 cents, we must call it florins 11·032 stivers = £1. The Belgian, French, and Swiss quotations present no difficulty, they are for francs and centimes. Genoa is for lire and centesimi to the pound sterling. It is when we get

to Spain we find a peculiarity introduced; the cable exchange is given in pesetas and centimos to £1, while the price for three months bills is marked 46⅞d. The meaning of the latter rate is, that for each 46⅞d. paid in London the dealer will sell a bill for 5 pesetas drawn on one of the principal centres in Spain, such as Madrid. Lisbon and Oporto rates give the number of pence which it will take to purchase one milreis. Copenhagen, Christiania, and Stockholm are all for kroner and ore to £1.

These little idiosyncrasies all go to confuse the young student, and even the seasoned operator may be forgiven for sighing for the time when all the rates will be quoted in the same way, and not some in foreign currencies and others in sterling. The trouble does not always end when one becomes familiar with the rates; we in England are so used to seeing prices quoted differently; generally the Englishman gets a price stating the number of articles for a given sum of money, in the Course of Exchange he gets the prices for definite articles. It would be all right if we were familiar with quotations such as "2" for articles costing 10s. each, or "4" to £1, instead of 5s. each, and if the after-lunch cigar, instead of being priced at 6d., was scheduled at "40" to £1, we should then soon get into the habit of seeing at once whether our charges for various items were rising or falling, and, in addition, the foreign exchanges would have no terrors for us; still, our City editor might then lose his delightful task of enlightening us, which would be a pity.

The reader will notice that in the editor's introduction to this Course of Exchange he mentioned that rates on Belgium, Holland, and Scandinavia moved in our favour; what do we understand by that statement? Simply that more of Belgian, Dutch, and Scandinavian currency units were being given in exchange for the pound sterling. The Portuguese rate also favoured us, but be careful not to fall into a trap with that rate, which you will see is quoted in pence. Here, to be in our favour it means that the quotation must be such that we have to pay less pence for each milreis we buy, so

if the pence rate had gone up it would have been against London; as it was, the rate came down a fraction and was therefore in our favour. We also read "Spanish and Swiss currencies improved in value." Now, what is meant by that? As far as London is concerned, the answer is that in the case of the Spanish cable remittances we get less pesetas and centimos for each pound sterling, and with the three months' rate we pay more pence for each 5 pesetas we buy, or, to put it the other way round, if we are selling, we get less pence for every 5 pesetas we surrender. In the case of Switzerland, if Swiss currency has improved in value, obviously the pound sterling has decreased in value, therefore for £1 we shall get less of the Swiss francs and centimes if we are buying, and will have to give up more francs and centimes if we are selling.

It is therefore quite certain that when in the Course of Exchange we get rates quoted in foreign currency to the pound sterling, they are cheaper to us when they rise and dearer when they fall; but when we quote in pence, such as pence to milreis, pence to pesetas, and so on, they are cheaper for us when they fall and dearer when they rise.

We can check this by referring to the rates at which business was done on the preceding "On 'Change" day, that is, on 17th December, 1918. On that particular day business was done in Lisbon bills at 33½d. per milreis; on the 19th December, 33¼d. was the rate, thus showing that the purchaser of bills in London drawn on Lisbon had only to pay 33¼d. for each milreis as compared with the 33½d. paid on the 17th December. Spanish cable remittances were sold on the same date at the rate of 23 pesetas 85 centimos to the pound sterling, but on the 19th December 23 pesetas 83 centimos only were given in exchange for £1, indicating that the rate had moved against London and in favour of Spain.

It remains to be added that the two columns in each case represent two classes of remittance, the first column is for bank remittances, the second for commercial remittances. In other words, bank bills cost more than the commercial bills—the reader will note that he receives less of the foreign

units in the case of the foreign money for the better class of paper. Note Paris: in exchange for one sovereign you get 26 francs 35 centimes if it is a bank bill, but if you agree to take a commercial bill, the dealer throws in 15 centimes more, that is, your rate will be 26 francs 50 centimes. The latter is, therefore, the cheaper bill because you get so many more of the foreign units for your pound sterling, and the reason is that the commercial bill is inferior security to the bank instrument.

Finally, in both the foreign exchange quotations and in the course of exchange, the cheques are popularly known as "Short Exchange," while the bills at three months' date are called the "Long Exchange." A brief explanation will make this clear. Let us take London first. If we are buying bills in London drawn on Paris, the long rate, or long exchange, is simply the short exchange with the amount of interest for three months *added* to it. For example, short exchange was 26f. 96c. in our Course of Exchange; suppose the market rate of interest was 5% in France. Five per cent. for three months added to 25f. 96c. is 26f. 28c. (25·96 + ·324), to which has to be added a small charge for French stamp duty and a trifling sum often charged for contingencies, in all, say, ·07 centimes, and we get a rate of 26f. 35c. as the "long," or three months' rate for bank bills drawn from London on Paris.

If, however, we are operating in the reverse direction and are drawing bills in Paris on London, and we take it that the same rate of interest—5%—is current, instead of adding this interest we *deduct* it from the short exchange, and the result is the three months' rate on London in Paris. Referring to our foreign exchange list again, we see Paris quoted 25f. 97½c. and deducting from this three months' interest at 5%, say, ·324, we get as the answer 25f. 651; and allowing for stamp and charges, the three months' rate comes out at 25f. 626c.

Strictly speaking, this addition or deduction from the short exchange is merely another way of expressing the discount allowed for the time the bill has to run. The banker

has the use of the money for three months and the small amount he pays in interest is by way of compensation for the privilege of having the amount of the bill in his hands for the period in question.

It seems a little funny, too, for the novice to deduct the interest or discount from the short exchange in one case and add it in the other, but a little thinking will soon show the reason. Start with the London quotations and take Paris again. You will notice that for a bill payable in three months' time you obtain 39 centimes per pound sterling more than you do if you purchase a cheque or cable transfer. This is because immediate payment has to be made by the banker on the other side, and in the other instance he will not pay away the cash for three months, so he has to give you such an amount over and above the short exchange as will enable the person to whom you send the bill to sell it and still receive about the same amount as if you had sent him a " short " bill. Now take the other side, for cheques drawn *in Paris* on London, which have to be paid immediately the cheques are presented to the bank in London. The rate is 25 francs 97½ centimes, but if a banker sent me a bill for three months, 25 francs 62 centimes per pound sterling will be the rate, since as the banker has not to pay the money out for three months, his correspondent in France can afford to sell you sterling bills in Paris drawn on London in exchange for a less number of francs than he would demand if you wanted from him a cheque payable on demand, or desired him to send a telegram from Paris to London asking his English correspondent to pay so many pounds sterling to a named person.

Speaking of cable remittances reminds one that the appearance of the word " cable " in these Continental quotations is an innovation which has mainly come about through the Great War. Formerly, we generally had only the " cheque " quotations to worry us, but owing to the great delays that have taken place in the despatch and receipt of mails, foreign exchange dealers have had to work on a telegraphic business.

Whether they will continue this method after the Peace Treaty is finally signed remains to be seen, but it must not be forgotten that it has been possible all along to purchase cheques or demand bills if one desired such a form of remittance. Telegraphic quotations have been devised more as a convenience to the bankers and others operating in exchange than for anything else, so possibly, if only on account of the extra expense, they may soon die a natural death.

In conclusion, we may here anticipate a likely question which might arise in connection with these sterling bills drawn from Paris, or, for that matter, from any other centre, on London. The point was once raised by a member of the audience at a lecture given by the author on foreign exchanges. This matter of three months' bills had been explained at some length, when a gentleman with an enquiring turn of mind jumped up with this poser—

"That's all very well, Mr. Lecturer, but suppose I happened to be the creditor in London to whom is owing, say, £100, it won't benefit me one little bit if a sterling bill is sent to me payable at three months' date, and the chap in Paris gets it cheaper than he would have done had he sent me a demand bill or a cheque, or had remitted the money by telegraphic transfer. The buyer in France would get the benefit, while I, if I wished my banker to buy the £100 bill from me, would be mulcted by his deducting the market rate of discount for three months; so if I had sold my goods for £100 net, I should be in the unhappy position of receiving less than £100 for my sale."

The answer in such a case is, it would all depend upon the terms of the contract between the parties to the transaction. If the terms were that the goods were supplied in exchange for payment by three months sight bills, the seller of the merchandise would have nothing to complain about, and having received the £100 bill he would either have to wait for three months (plus three days of grace allowed by English law) before he could demand his money, or, in the alternative, he could sell his bill under discount and receive a little less

than £100. On the other hand, if he had made hard and fast terms to the effect that the buyer of the goods was under obligation to pay him £100, neither more, nor less, then the remitter from France, if for any reason he desired to send the London man a three months' bill, would naturally be obliged to purchase a draft in Paris for a sufficient amount over and above £100 as would out-turn the exact sum required in London.

As a final word on this subject of interest or discount on bills of exchange which are drawn payable other than at demand or at sight, it might be well to point out that it is important for the student to remember that when it is a question of turning the bill into immediate cash, the discount is calculated at the rate current on the market in which the bill is *payable*, not in the place where the bill is *bought*. Moreover, the place in which the bill is payable is not always the centre where the bill is accepted, for in numerous cases bills are drawn on and accepted in one country, but are made payable in another country. For example, many bills are drawn on and accepted in Paris, but are payable in London.

CHAPTER VII

Which shows how Bankers confer upon clients the right to draw Bills of Exchange.

From time to time throughout this book we have spoken of the drawing of bills of exchange without troubling ourselves whence the bills emanate, or by what right persons or firms draw upon one another for sums of money. We have spoken of bankers' bills and of commercial bills, just as though it were the simplest thing in the world to scribble out on a piece of paper a demand for a certain sum of money, address it to a certain person, and forthwith proceed to sell it for what it will fetch according to certain well-defined rules and regulations. Now, if the ordinary supply of bills of exchange runs out, bankers and finance houses can, and very often do, manufacture bills of exchange and sell them to persons requiring them: they are able to sell them because they are well known as bankers, and the houses upon which the bills are drawn up are usually reputable bankers, too. With ordinary persons, it is not always so easy or simple to raise the wind, so down a long vista of years there has been evolved a system by which merchants, traders, financiers, and private persons are able to draw bills of exchange and procure money upon credit, so to speak. The system we refer to is that known as the drawing up and issuing of a Letter of Credit, which is usually a banker's authority to another person to draw bills upon the banker.

The letter of credit in its simplest form is probably that delightful document with which you furnish yourself before you set out on a more or less extended and pleasant journey round the world—in a word, a Travelling Letter of Credit.

Such a document is generally issued by a banker to clients for the purpose of enabling them to obtain money as and when most convenient to themselves on arrival, or during a sojourn in a foreign land. It is a polite request from the banker to his foreign agents and correspondents to furnish the person in whose favour it is drawn with funds—in effect, it is really an authority for the named holder to draw bills which the foreign bankers cash and send forward to the issuing banker for payment. The total amount up to which a beneficiary may draw is always stated plainly, both in figures and words, the object being to limit the sum for which the banker is liable; he, we may be sure, has no desire to give unlimited credit to his client, especially when that client happens to be travelling abroad. In this connection we have heard of unlimited credit being given, but only in novels! Alexandre Dumas, for example, tells us of some such document being in the hands of the immortal Count of Monte Christo. Our readers will possibly remember the fiendish delight with which the worthy Count called upon M. le Baron Danglars with the authority of Messrs. Thomson & French, the Italian bankers, to open an account with Danglars for an unlimited sum. What these bankers were supposed to have given the Count of Monte Christo was a traveller's letter of credit entitling him to draw upon the French banker, Danglars, for any sum he pleased—Thomson & French, of Rome, having set no bounds to their engagements. In the circumstances, we may pardon Danglars for expressing surprise at the unusual form of the authority, and even sympathize with him when the inimitable Count still further perturbed him by producing two similar letters of credit, the one granted by Viennese bankers, authorizing him to draw upon the house of Rothschilds, and the other one granted by Baring Brothers & Co., of London, instructing the French banker, Laffitte, to honour the Count of Monte Christo's signature to an unlimited extent. Such an occurrence is, however, merely the product of the fertile imagination of Dumas, and is never likely to occur in practice, even

though the client be a multi-millionaire. True, we have the case of the Good Samaritan's credit in the Bible, already mentioned; he gave the innkeeper two pence to expend upon the man who had fallen among thieves, and promised to repay whatever else the innkeeper expended, or, as we should say, advanced—in a way, that was unlimited credit. But bankers to-day are not philanthropists, they are the custodians of other people's money, and as such are bound to take steps to limit their liability on any credits granted.

After which digression, let us return to the traveller's letter of credit.

Generally speaking, the bills that come forward as a result of drawings under such credits are demand bills. Sometimes the foreign bankers who pass over cash in the foreign town to the holder of the credit, get him to put his name to a form of demand bill, and then pay over the amount; in other cases the banker simply requests the beneficiary to sign a receipt, which amounts to the same thing, since in practice both forms eventually reach the banker who has issued the letter of credit, and he has to recoup the foreign correspondent for the amounts paid out.

There are, however, many other forms of letters of credit issued by bankers, and the principal ones with which the exchange student will meet early in his career are those used in connection with the import and export trade of a country. They are many and varied, and it would take a whole book to describe the ramifications of the numerous credits in force, so it will perhaps suffice if we give a summarized account of those more frequently seen in daily commercial intercourse.

Before describing the actual credits, let us see how they arise. We will suppose we are in Manchester and we desire to send out to China a shipment of calico piece goods. We are anxious to obtain our money before we part with the goods, how shall we get it ? Well, one way is to draw out a bill of exchange upon the consignee on the other side of the world, somewhat in the following form—

Exchange for £100.

Stamp 1s.

No...... *Manchester, 11th Feb., 1919.*

At three months after sight of this first of Exchange (second and third of same tenor and date unpaid), Pay to the Order of the Blanktown Bank, one hundred pounds, value received.

John Jones.

To Timothy Brown, Esq.
Shanghai.

We attach this bill to the shipping documents—say, bill of lading, policy of insurance, invoice, etc., and then try to get a banker to purchase it from us. But suppose the banker is nervous about taking the risk, and bankers very often are nervous unless they know the shipper very well indeed—what are we to do? One method is to ask the importer in China to communicate with his banker over there and get him to wire or write to his agent in London or Manchester to hand us an authorization to draw bills upon either the banker or the importer in China under a more or less stringent guarantee that the bills will be accepted when presented and paid in due course. With that authority in our hands, we can take our bills to the banker in England and he will buy them without further ado.

Now let us transfer our affections to Burma. Say we have a good fellow out in Rangoon from whom we are anxious to obtain some of those indigestible beans with which food controllers have so often fed us during the war. The dealer in these beans at Rangoon is quite ready to send them to London, but he wants rupees as soon as they are put on board the steamer, how are we going to manage to oblige him? The procedure is simple. We go to our bankers, say the Hong-Kong and Shanghai Banking Corporation, and ask them to advise their Rangoon branch to acquaint the exporter of beans with the fact that a credit has been opened with them guaranteeing that his bills will be met with due honour—

that is, accepted and paid, if drawn and accompanied by shipping documents for the cargo of this article of food. The Rangoon Agent of the Hong-Kong Bank will, on receipt of this information, advise the shipper, who will then prepare his bill, present it to the bank with the shipping documents, and so get his money.

This, then, is a rough description of what happens in the case of imports and exports, but let us look a little further into the matter to see what manner of document it is that these banks hand over in such cases.

First we get what is known as a Banker's Credit. This credit by previous arrangement with the bank, usually takes the form of an authorization by the importer to the exporter to draw bills upon a certain named bank, and, at the request of the importer, this bank, when the bills come forward, undertakes to accept them on behalf of the importer, subject to compliance with the terms of the credit. Later on, the bank having placed its name on the bills as acceptor, will pay them when presented by the holder, though, of course, for this purpose he is put in funds by the importer in good time before the acceptance arrives at maturity.

A banker's credit sometimes takes the form of an intimation from one bank to another that a merchant or bank has opened a credit with them for bills to be drawn under terms, and this intimation is often accompanied by the statement that the credit is an " Unconfirmed Credit," that is, it is merely an advice, consequently the right of cancellation is reserved. It should be noted that even under an unconfirmed credit the exporter does not draw his bills on the importer, but on a bank, although the bank in this case does not guarantee or confirm in advance that it will accept the bills. It is as if the bank said: " We will accept the bills drawn upon us, but we do not definitely undertake to do so." In an unconfirmed credit you would find no clause such as: " We undertake to honour the drafts." This credit is valid until cancelled, and some banks go so far as to say that there is a right of cancellation, whether the beneficiary agrees or not, a point

which lawyers will sooner or later decide to the greater or less satisfaction of interested parties.

Next we get a Confirmed Bankers' Credit, and the difference between this document and a banker's credit without the word "Confirmed" should be noted carefully. A confirmed banker's credit is one issued by a bank in which that bank undertakes, subject to the fulfilment of certain terms and conditions, to accept and pay at maturity the bills drawn under the authority so given. It is the banker here who gives the actual authority, not the importer. People working under these credits understand quite well that the bank issuing such a document will not, within the prescribed currency of the credit, cancel it without the concurrence of the beneficiary. Then, again, the reader should bear in mind that, with a confirmed banker's credit, the drawer of a bill has the assurance of the bank that it will accept his bill on presentation; in the case of the unconfirmed credit he has no such assurance.

There is one point which deserves to be noticed in connection with these bankers' credits. It is this: the foreign and colonial banks who negotiate bills drawn under such credits are frequently not the banks who have actually opened the credits. A few words will make this clear. We may assume that you go to one of the Colonial branch banks in London and ask them to purchase the bills of Tom, Dick, or Harry abroad against shipment of some commodity to you. "Sorry," says the banker, "but you must get a confirmed banker's credit for that business." Well, as you want the goods, there is nothing else for you to do but to go to your own banker, who will probably agree to give the credit required, so he arranges details with you and when the credit is fixed up he sends along to the Colonial bank a request to advise out to its branches abroad a confirmed banker's credit. In a word, your bank confirms that it will accept the bills drawn upon it subject to terms and conditions, and the foreign or Colonial bank is only the intermediary through which the credit is worked: we might even go so far as to

say that it is a sort of double opening of a credit. The reason for this curious practice is that in exchange banking it is a vital necessity for exchange banks to keep their funds liquid; in financing foreign trade they want to be in a position to buy and sell bills, and do not care to tie up large sums in acceptances, which would preclude their financing the large overseas trade promptly and effectively.

There is still another form, which is perhaps more widely used than any other. It arises in this way. The importer knows the exporter will not send goods along unless some arrangement can be made for him to get his money on the spot, so what he does is this: he goes along to the banker, say, in London, with whom he is well acquainted, tells him the position, and the banker arranges the matter. What the importer says to the banker, in effect, is this: "I have a consignment of goods coming forward from India, you might get your branch out in Bombay to negotiate Abdul Mahomed's bills on me at three months sight." "Very well," answers the banker, "but fill up this form first." The form the importer signs is something like this: it generally begins with the words, "Please open a documentary credit in favour of so-and-so," then mentions the total sum up to which bills are to be drawn, gives a few particulars of the merchandise to be shipped, and a few other details regarding insurance, etc., and in consideration of the bank's agreeing to instruct its foreign branch to negotiate the bills, he, the importer, agrees to accept them when they are presented to him in London, and to pay them at maturity. When this form is completed and signed, the London banker sends out an advice, either by telegram or by mail, according to the arrangement made, instructing his Indian branch to communicate its contents to the shipper there. When the advice reaches India, the banker there acquaints the exporter of its terms, and often favours him with the gratuitous information that it is not a bank credit. In fact, if you ask a banker what it is, he will tell you that it is merely an authorization to him from the importer to buy the exporter's

bills, on the distinct understanding that the importer will accept and pay them as and when due. All the banker does is to pass on the information and leave his foreign branch to act upon it or not, as it may deem proper at the time. In the advice to his foreign manager the banker doesn't say, "You must," or "You shall," "buy the bills of Mr. So-and-So"; he contents himself with the words: "You may buy," or "You may negotiate the bills," and the effect, obviously, is to allow the manager on the spot a good deal of latitude in his dealings with the foreign exporter.

We have arrived at this point, then, that the exporter in India has received this advice; what he does is to prepare his bills and all the rest of the paraphernalia connected with the shipment, and in ninety-nine cases out of a hundred, if everything is in order, the banker abroad takes the bills and other documents, pays over the money, and sends the complete set to England. In the course of time they reach the London bank, which presents the bills to the importer; he accepts them, and pays the bills in due course.

Now all these credits may be made revolving. That is to say, when bills for the total amount named in the credit have been drawn, the credit can be re-opened for a like sum for which the original arrangements were made, always supposing it is the banker's pleasure to fall in with the wishes of the traders on this point. The banker, may, of course, decline to negotiate any more bills until some or all of those already drawn have run off, and in that event, when the credit is exhausted, the person operating on it cannot pass more bills through the bank. Importers nowadays, however, are quite ready to meet this emergency should it arise, for they make arrangements with a number of banks to open credits for them, and in that way although the total indebtedness of a firm on bills drawn under credits may be large, the risk, as far as the banks are concerned, is distributed, each bank, so to say, taking a share of the finance of the bills in connection with a firm's shipments.

The credits we have examined by no means exhaust those

in vogue, but they are sufficient to indicate to the reader some of the channels through which bills pass before they eventually find their way to the London and other financial centres.

It is plain that the opening of these credits by bankers in connection with the foreign trade of the various countries has for effect the bringing into being of a large proportion of the bills of exchange whose tortuous career we have investigated step by step throughout the preceding chapters. It by no means follows, however, that the bills are always drawn against shipments of commodities; there are drawings in plenty against shares and securities of all descriptions, and any one who has transactions of any magnitude passing through his hands will often meet with bills of exchange attached to share certificates, or even transfer deeds. Other bills are constantly drawn clean; that is to say, they have no documents of any shape or form attached to them. The mention of clean bills reminds us, too, that there are what are known as clean credits. A clean credit is one which authorizes the drawing of clean bills, and bankers as a rule are very chary about opening them, since if anything goes wrong with the business, that is, if the drawee for any reason refuses to accept the bill, or, having accepted it, is unable to pay it at maturity, obviously there is no tangible security upon which the banker can exercise a lien pending payment, or the settlement of the claim against the drawer.

However, to return to the bills with documents attached; these, generally speaking, fall under two headings, those marked "D/A" and those marked "D/P." When these bills from abroad reach the hands of the banker, the first thing he does is to present them for acceptance. In the case of the D/A bill, which, being interpreted, means Documents on Acceptance Bill, immediately the person upon whom the bill is drawn accepts it, that is, writes across the face of the bill the words, "Accepted—payable at the Boniface Bank 24/1/19—John Jones," the bank hands over the documents. With the "D/P" bill, that is, a Documents on Payment

Bill, notwithstanding the fact that John Jones accepts it, the banker will not hand over the documents until John Jones pays the money. In the former case, the acceptor of the bill, having the documents of title to the shipment, is in a position to obtain delivery of the goods; in the other instance, he cannot get his goods until he pays the bill; consequently, acceptors of D/P bills, if they are in urgent need of the consignment, generally pay them before maturity, receiving in consideration a rebate on the amount of the bill, according to the rates ruling at the time.

It is a matter of the financial standing of the parties to the bills. If both drawer and drawee be in good repute, there is no difficulty in getting bills on the "D/A" basis, but if either is not strong financially, the banker will be doubtful about taking their paper except on "D/P" terms.

Now when bills are completed by acceptance, the exchange bankers do not usually keep them in portfolio for long; they need the capital to buy other bills for outward shipments, so what the banker does is to instruct a bill broker or discount house to sell the bills for him. D/P bills are not easily discountable except at a sacrifice in the discount rate the banker has to pay, but the D/A bills usually find ready takers. When the broker or discount house has found a buyer for the bills the banker holds, the banker endorses each bill and hands over the parcel in return for the bill broker's cheque. With the endorsement of the banker on them, these bills represent the paper in which dealings take place almost every day in London. The reader will see the daily quotations in the Money article of his newspaper under the heading of "Bank Paper," which includes all those bills bearing the endorsement of first-class bankers, as well as those bills drawn on and accepted by the bankers themselves.

In close proximity to the heading "Bank Paper," the student will find in the Money article another heading—"Fine Trade Bills." Fine trade bills do not represent foreign bills at all, they include all acceptances of first-class merchant and trading concerns in the inland or domestic trade of the

country, and are of very little interest to the exchange dealer. Bank bills, of course, command a much better price than fine trade bills, or, in other words, if one is selling a bill under discount, the rate charged will be less in the case of the better class paper. At the time of writing, in fact, people willing to buy bank bills will deduct only 3½% on three months' bills, but if purchasing a fine trade bill, they require an allowance of 4% for the same usance as the bank bill, viz., three months.

There are a few points about which the young novice should be careful when dealing with documentary bills. We have spoken of the bill being accompanied by a full set of shipping documents. A "full set of shipping documents" includes all the copies of the bills of lading which have been signed; nowadays they are usually in triplicate, but the smart clerk can always see the exact copies issued by referring to the bill of lading itself. In the body of all bills of lading there is a space in which should be inserted the figures showing how many copies have been signed, consequently the trained man seeing this number marked, quickly runs over the bills of lading delivered with the bill of exchange to find out if the correct copies as stated are there, that they are all identical with the original copy and properly endorsed; in fact, he must see that all copies exactly correspond. The insurance policies should also be examined to see that they are properly drawn up, endorsed, and that the amount is sufficient to cover the invoice value plus a reasonable margin of profit. Then a further glance should be cast over the documents to see that the correct number of copies of the invoice are there, and that each invoice corresponds with the original copy, of which it is to all intents and purposes an exact facsimile.

There is still another document which accompanies foreign bills, that is, a letter of hypothecation. It is a form of letter of lien signed by the drawer of the bill giving the bank or holder full power to deal with the relative goods in case of emergency. By signing this document and handing it over

to the bank, the exporter practically pledges his goods. The reason for banks calling for a letter of hypothecation is, in case anything goes wrong at the port of discharge. The drawee of a bill, for example, might refuse to accept either the bill or the goods, then the bank has to make arrangements for storing them or for their sale, and after accounting for the proceeds and expenses will, of course, come down on the drawer for any deficit that may result. Most of the banks now content themselves with taking a general letter of hypothecation where there are a series of transactions or bills to be drawn, and as this is made to cover all the shipments, it saves the drawer making out a separate letter of hypothecation each time he sends out a batch of bills and documents for negotiation.

The credits issued by some banks practically do away with the necessity for a letter of hypothecation. The following form of request, for instance, would appear to make it unnecessary to call for an additional hypothecation of the goods to be shipped—

CREDIT NO. ______

REQUEST FOR CREDIT.

27th January, 1919.

To the AUSTRALIAN BANK, LTD.,
LONDON.

I/We request you, the Australian Bank (hereinafter called "the Bank," which expression shall include the Agents or other representatives of the Australian Bank), to establish a Credit with your Bank and/or Agents at Fremantle or Sydney to the extent of £1,000 (say, One thousand pounds sterling), authorizing the negotiation of the draft or drafts of the Tallow Exports Co., Ltd., or of a nominee or nominees appointed by him/them in writing drawn on us at sight and/or 30 and/or 60 days after sight, payable in London, provided every such draft be accompanied by Invoices and Bills of Lading purporting to be for a shipment or shipments of butter and/or tallow (hereinafter referred to as "the goods") of at least equivalent value (inclusive of charges), and in consideration of the Bank establishing the Credit I/We hereby undertake and agree to accept unconditionally every such draft on presentation, and to pay same at maturity, with cost of insurance and stamp added.

And it is understood and agreed as follows—

1. The Marine Insurance for full invoice value for tallow shipments,

with 5 per cent. added, is to be effected by shippers to the satisfaction of the bank, to whom the Policy is to be handed, if not so effected, the Insurance may be effected by the Bank at my/our cost.

2. In the event of my/our failing either to accept or to pay any such draft or drafts, with cost of insurance and stamp, I am/we are to have no claim whatever against the Bank in respect of the relative documents or the goods, but I am/we are to remain and be liable to the Bank in respect of such draft or drafts, insurance and stamp, and also for interest at five per cent. per annum or at Bank of England rate whenever same is above five per cent. from the date of dishonour of the said draft or drafts, receiving Credit against the amount of such liability for the net proceeds (if any) of the goods represented by such documents actually realized by the Bank, and for the net proceeds received by the Bank in respect of any insurance thereon.

3. On due payment of any draft, with cost of insurance and stamp, the relative documents are to be given up to me/us provided I/we have then duly met all my/our obligations hereunder.

4. The negotiation of drafts in pursuance of this request shall be optional on the part of the Bank.

5. The Bank is not to be responsible for any irregularity as to any of the documents, or for any misrepresentation as to description, quantity, quality or value of the goods or otherwise, nor for the shippers' charges in respect of the goods, nor for the terms, conditions, or sufficiency of any insurance by whomsoever effected, nor for non-insurance of the goods.

6. This credit is available until 27th July, 1919.

(*Signed*) EXPORTERS IMPORTERS CO., LTD.,[1]
LONDON.

6d.
stamp.

Finally, there is the Certificate of Origin, which, in time of war, especially, is called for. This is a certificate, usually signed by the consul at the place whence the goods emanate, setting forth the true origin of the shipment, and during the war it served to show that there was no enemy taint about the goods.

As regards the bill of exchange itself, the careful student will find that precautions similar to those he will take with the other documents are most necessary. Where first,

[1] *Cf.* E. J. Osborne: *Lecture on Foreign Bills* (Melbourne).

second, and third of exchange are called for, he must see that the full copies are there, that the second and third correspond with the original bill, and that bills are properly stamped in accordance with the law of the country in which they are drawn. The idea of drawing the bills of exchange and other documents in duplicate and triplicate is to provide against loss in transit; the first of exchange, together with the relative shipping documents will be sent off by the first mail and the others by subsequent mails, some probably by one route, the remainder by another. This practice proved to be a very useful precaution during the Great War, when the submarine menace was at its height and the sea ruthlessly sown with mines and other diabolical instruments of war.

CHAPTER VIII

Favourable and unfavourable exchanges: the methods for correcting adverse exchange—The gold question—Paper and exchange.

The individual begins to get at grips with the problem of foreign exchange when he has to decide for himself what is or what is not a favourable rate of exchange. Leaving Imperial interests out of the question, an exchange is unfavourable only to those who have to send money abroad: it is unfavourable when the individual has to part with more of the currency of his own country for a less number of units of the foreign country than he would have received had exchange been normal. It is the importer who has to pay the money to a foreign exporter who will first feel the unfavourable rate of exchange, and obviously what is unfavourable to the importer will be favourable to the exporter. For example, if the exporter's invoice is for 10,000 francs, and French exchange is against London, for fewer francs than ordinarily he will get more pounds sterling in exchange. This all brings us back to our rule about high and low rates; applying the rule to dealings in exchange, we find that, as far as London is concerned, high rates are favourable to the buyers of bills of exchange, low rates unfavourable; that is, when dealing with foreign money to the pound sterling, but when quoted in shillings and pence to the foreign units, high rates become unfavourable, while low rates are favourable. As far as the seller of bills of exchange is concerned, the reverse is the case; when rates are quoted in foreign money to the pound sterling, the seller will find that low rates are favourable and high rates unfavourable, and if he is selling bills based on rates which are quoted in shillings and pence to the foreign units, high rates will be favourable, low rates unfavourable. Where the importer loses on this side through the adverse exchange, the exporter on the other side gains, and in the case of the exporter's suffering on this side from

the unfavourable exchange, it is the importer abroad who benefits.

Adverse exchange tends to work out its own salvation, though in time of war it is a terribly slow process. Its influence is to stimulate exports and to discourage imports, for if exports are from this country to a foreign centre, they may be paid for by the foreigner with a smaller amount of the currency of that centre—the foreigner buys relatively cheap; but as adverse exchange increases the cost to us of everything we get or import from the foreign centre, we buy relatively dear. This position has been made perfectly clear during the war; in Holland and the Scandinavian centres, for instance, owing to the interruption in the free flow of gold and other circumstances, exchange was heavily against London. Therefore, it was advantageous to those neutrals for us to export goods to their centres, for they had to pay a comparatively smaller number of florins and cents, kroner and ore for each pound sterling represented. Then, greatly to our disadvantage, everything we wanted from those countries was obtained by our paying a larger number of our currency units for each pound sterling's worth of goods we purchased. The worst of it was that exchange, as in normal times, did not seem to be able to work out its own salvation; our exports did not increase in anything like the proportion they should have done owing to the shipping position and other obstacles in connection with the war, while imports increased heavily. The gain seemed to be all on one side—that of the foreigners. In normal times exports would have increased and the effect of this upon exchange, plus the effect from other causes, which we shall now proceed to investigate, would have brought exchange back to its normal level. The fly in the ointment during the war has been gold shipments, or, rather, the non-shipment of gold in support of exchange.

In explaining the theory of specie points in exchange, we have mentioned once or twice the saying that bills of exchange will be sent in settlement of indebtedness up to a certain limit. The taker of bills of exchange will purchase them,

and although exchange rise will keep on buying bills until exchange reaches that point at which it will be just as cheap to send gold to pay off the debt. It will be easier, perhaps, if we explain this by reference to the dealings in bills of exchange. If at any particular time there are many and large buyers of bills, say, Amsterdam on London, and the demand exceed the supply, the price of bills of exchange must rise, though the limit of such a rise in ordinary circumstances will be that at which it is just as cheap to send gold as to buy a bill of exchange to send to London. That, as we have seen elsewhere in this book, will be the Amsterdam export gold point. Conversely, if the supply of bills exceed the demand, the price would naturally fall to that point at which it would be just as profitable for the seller of bills, our Dutch creditors, to take the gold from London, which would be their import gold point.

It by no means followed that directly exchange became adverse people would refrain from buying or selling bills of exchange. At a price, there are generally bills to be purchased, since when the ordinary supply of commercial bills runs out, the bankers step in and "make" bills. That is to say, they draw bills on their foreign correspondents and sell to those wishing to purchase at the high rates ruling. Now these sales by the bankers cannot go on for ever; generally speaking, the rate of exchange at which a banker will sell bills depends upon the rate at which he can cover his sales, that is, provide cover to meet his drawings by purchasing other bills. He may buy bills direct on the centre upon which he has himself sold, either at the time, or take his chance of purchasing remittances before the time of payment is at hand, or he may carry out what is known as a three-cornered transaction; that is, buy bills in a third country and send them in payment of his drawings on the foreign centre. Sooner or later, however, the time comes when he finds himself with what is called in exchange banking, an "oversold gold account"—he has sold more gold bills than he has been able to provide cover for. In the circumstances, he has no

alternative but to resort to gold shipments in settlement of his indebtedness. In a word, exchange may be said to have reached the point when it became profitable for bankers with oversold gold accounts to export gold.

Now when a country sends gold in settlement of an adverse balance it may be described as an application of the gold corrective, that is to say, by exporting gold it cancels its indebtedness and corrects, or turns, exchange again in its favour. Prior to the war, if the application of the gold corrective was not sufficient to bring about the desired result, and the continued export of gold was such as to threaten the ultimate gold reserves of the country, we in England used to pin our faith to a sharp rise in the Bank of England Rate. That usually had the required effect, since among other things it became profitable for foreign investors to buy London bills here owing to the higher rate of interest to be gained on their money, and it also paid others to leave their balances in London instead of drawing them away to a foreign centre where the rate of interest allowed was lower. The general experience was that the increase in the bank rate in any country tended to create elsewhere high rates of exchange on that country and, *pari passu*, a flow of gold to it. As the war progressed, however, the principal nations of the world seemed to have come to regard a rise in the rate of interest as of much less importance to the exchanges than it used to be. The reason behind it all, has been the interference with the exports of gold. Numbers of nations believed it incumbent upon them to husband their gold supplies, not an ounce more of it left their shores than could possibly be avoided; exchange rates every day were seen to be ruling at points far removed from those at which gold shipments in ordinary circumstances should commence, and high interest or bank rates did not have much effect. In hoarding their stocks of gold, most nations seem to have worked on the premise that once they started shipping gold in support of exchange, the drain on their reserves would be such as to take away practically all they possessed of the metal. Whether that

contention is right or not, we shall presently examine; for the moment it will be well to glean interesting information from the reports of various Committees that have been sitting on these questions of credit, currency, and foreign exchange.

Let us see first what the Committee on Financial Facilities has to say on the question.

This Committee in its report shows that in normal times the necessity for maintaining an effective gold standard acted as an automatic check upon the undue expansion of credit. An undue expansion of credit, it should be noted, has always an adverse effect upon the exchange of the country in which the excess of credit is ruling. In the case of our own country, one of the first things apparent was the balance of indebtedness between Great Britain and foreign countries, and as soon as this became unfavourable, the exchanges moved against us. It then, says the Committee, became profitable to export gold to meet foreign claims. This export caused a gradual shrinkage in the available supplies, and a consequent reduction in the Bank of England ratio of reserve to liabilities, and so necessitated a rise in the Bank Rate, which, in turn, caused a general rise in interest rates. This rise in interest rates had a twofold effect. In the first place, it attracted gold to this country and induced gold which otherwise would have been exported to remain, and consequently it induced people to pay off loans and discouraged new loans being sought for and created. If the drain on gold was severe, money became "tight," that is, people in need of funds, borrowers and the like, found it difficult to obtain accommodation, and it became difficult to renew existing loans; this caused the sale of goods and produce upon which the loans were secured, and so brought about a fall in prices which encouraged exports and discouraged imports, and so gradually adjusted the situation. Further, as the manufacture of banking credit by the process of granting loans also involves a corresponding increase in the deposit liabilities of the Bank of England, the amount of additional loans which it was safe to grant had to bear a relation to the supply and possible demand for gold.

Coming back to the long-continued sales of bills by bankers, and to the subsequent necessity for them to resort to gold shipments, the reader will observe that the banks were all the time adding to the supply of credit and so making it expand until its adverse effects upon exchange were apparent, and the shrinkage in our gold supplies plain to the most casual observers.

The Committee on Currency and Foreign Exchanges also gives a very valuable *résumé* on the subject, and although in giving its findings we are repeating to some extent the information already before the reader, the clauses in the report, in so far as they concern the foreign exchanges, are too valuable to omit, besides a little reiteration will do the student no harm, and may, perhaps, even make him learn against his will.

After showing that gold was freely coined by the Mint without any charge, that there were neither restrictions upon the import of gold into this country, nor obstacles in the way of the export of gold from our shores, the Committee goes on to say—

When the exchanges were favourable, gold flowed freely into this country. When the balance of trade was unfavourable and the exchanges were adverse, it became profitable to export gold.

Now notice their explanation of the way the gold was obtained—

The would-be exporter bought his gold from the Bank of England and paid for it by a cheque on his own account. The Bank obtained the gold from the Issue Department in exchange for notes taken out of its banking reserve, with the result that its liabilities to depositors and its banking reserve, were reduced by an equal amount, and the ratio of reserve to liabilities consequently fell. If the process were repeated sufficiently often to reduce the ratio in a degree considered dangerous, the bank raised its rate of discount. The raising of the discount rate had the immediate effect of retaining money here which would otherwise have been remitted abroad,

and served to attract remittances from abroad to take advantage of the higher rate, thus checking the outflow of gold, and even reversing the stream.

If the adverse condition of exchanges, continues the Committee, was due not merely to seasonal fluctuations, but to circumstances tending to create a permanently adverse trade balance, it is obvious that the procedure thus described would not have been sufficient. It would have resulted in the creation of a volume of short-dated indebtedness to foreign countries which would have been in the end disastrous to our credit and the position of London as the financial centre of the world. But the raising of the Bank of England's discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed, and the demand for constructional materials and other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried on largely with borrowed money, being confronted with an increase of interest charges, if not with actual difficulty in renewing loans, and with the prospect of falling prices, tended to press their goods on a weak market. The result was a decline in general prices in the home market which, by checking imports and stimulating exports, corrected the adverse trade balance which was the primary cause of the difficulty.

Here, again, the reader will trace the connection between the adverse exchange and the insistent and long-continued demand for bankers' bills. The demand upon the bankers for this form of remittance, and their efforts to keep up the supply, naturally arise from heavy imports. Imports go on and on, then the bills have to be met; they have to be paid for, and in default of sufficient exports, the bankers have to manufacture the wherewithal in the shape of bank bills which they sell to their clients who require them to settle their indebtedness to the foreign exporters of the commodities which have entered England. Ultimately the day of reckoning comes,

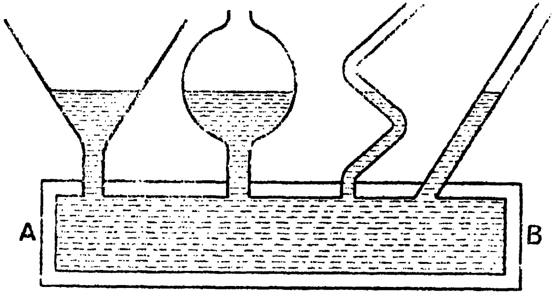
resort is had to gold to settle the difference, or, as we have described it, to correct the adverse exchange.

Concerning the fall in a number of the foreign exchanges below the old export specie points which has taken place since the early part of 1915, the Committee holds that this is not by itself a proof that the gold standard has broken down, or even ceased to be effective. During the war the submarine menace, high freights, and the refusal of the Government to extend State insurance to gold cargoes greatly increased the cost of sending gold abroad, states the committee; consequently the actual export specie point has moved a long way from its old position. In view of our enormous demands for imports, coupled with the check on our exports due to the war, it was natural that our exchanges with neutrals should move towards the export point. Therefore the fall in the export specie point would by itself account for a large fall in our exchange rates. Such a fall must have taken place in the circumstances, even though all the conditions of an effective gold standard had been fully maintained.

These quotations from the Reports of the two Government Committees completely explain the method by which the exchanges are corrected in normal times by shipments of gold, and the implication is that our supply of gold is insufficient to correct the whole of the adverse exchanges; which is very possibly true, but it is a moot question whether, if we and our Allies had had a little more confidence and had shipped gold to the centres whose exchange was adverse to us, the state of affairs might not have been different. As it is, supplies have been hoarded, the free flow of gold has been interfered with in most countries, and we have therefore no real means of telling what the ultimate effect would have been had other steps been taken.

Where a number of exchanges are adverse to us, it is no use our exporting gold to one centre only unless we are prepared to continue the shipments to that or other centres. The point it is wished to make clear is, that there is no lasting benefit to be gained from a single shipment of gold, for the

very simple reason that it is extremely difficult, if not impossible, to localize the effect. This may be better explained by comparing the gold exports with a phenomenon seen in hydrostatics, which the following diagram will illustrate.



Here are a number of glass vessels of different shape and different size, all opening into a closed vessel or tube *AB*, and it is found that if liquid be poured into any one of these vessels, it will, after filling the tube *AB*, rise to exactly the same vertical level in all. Similarly, if any portion be withdrawn from any of the vessels, the liquid will sink to its new position of rest through the same vertical height in each.

Very well, then, the point we maintain is that just as water poured into one of a series of connected vessels will raise the level of fluid in all, so any export of gold to one centre will affect the exchanges of all. And again, if gold is withdrawn from one centre, then the exchange not only of that centre but of all other centres connected with it will be similarly affected.

Exchanges, especially the European exchanges, rise or fall together, and it would seem, therefore, that conditions which affect the one must inevitably affect the others.

The steady export of gold has a remedial effect, but you must do more than send gold to one centre; otherwise, although the effect of your gold shipment, as has been stated, will be to set several exchanges moving together, the arbitrage dealer will step in and utilize the movements in exchange to

exact a profit by buying and selling exchange between the various centres, and so tend to make the last state of your exchanges worse than the first.

The writer remembers illustrating this in a lecture read to audiences both in London and in Melbourne, Australia. For the purposes of his argument he took a date towards the end of 1915, when exchange, London on New York, was quoted at \$4·68 to £1, that is, 3·7% against London. The rate of exchange between London and Amsterdam on the same date was 11 fl. 40 c., say 5·7% against London. In New York on the same date the rate of exchange on Amsterdam was 40½ cents to the florin, which is approximately 1% against the United States. Now, suppose on this occasion it had been possible for Great Britain by shipping gold to Holland to draw the Amsterdam rate up to the par of exchange—12·107 fl. to £1—operations of the following nature would probably have taken place. The American possessor of a London balance of, say, £10,000, could sell it to Amsterdam at the par rate and receive 121,070 florins (£10,000 × 12·107). At the same time he could sell a similar amount of florins in New York at 40½ cents to the florin, and would receive, say, \$49,032. But if he had sold in New York his London balance of £10,000, the arbitrage dealer would have obtained only \$46,800. His profit, then, on the former operation would have been \$2,232, representing 4½%. Therefore, if a number of exchanges are against you and you ship gold only to one centre, what you really do is to place an opportunity in the way of arbitrage dealers to exact a profit by dealing in what are called the "cross rates."

We leave this discussion of the gold question with the remark that our little analogy with the hydrostatic principle pre-supposes perfect freedom of flow in the connecting pipe (*i.e.*, free commercial intercourse), particularly in connection with the shipment of gold.

Finally, there is the question of note issues and their effect upon exchange. The principal evil in paper issues is the emission of inconvertible notes. The effect of such, or,

indeed, of any issue of paper currency, is to drive gold out of circulation, but the currency does not depreciate; or, to put it another way, prices of commodities do not begin to rise until the paper exceeds the actual quantity of metallic currency which has been superseded. Many people still fail to appreciate the fact that the products of the "printing press" do not, and cannot, satisfy creditors abroad; the foreigner does not want your notes, and he will do anything rather than take them. The author remembers some correspondence in one of the weekly papers on the subject. A writer had asked why we should not do away with gold money, seeing that most business is transacted with cheques; he could not see the use of gold, and wanted to know why a paper standard should not be feasible. He admitted, however, that the paper "sovereign" had proved to be not anything like as valuable as the pre-war gold sovereign, and was wishful for the old prices of commodities to return. The reply to his query was, that cheques are not currency and would be useless if there was no metallic currency. Secondly, a paper currency is bad because the paper has no intrinsic value. The great merit of a gold standard is that the unit of currency is equally valuable whether as coin or melted down. Generally speaking, it cannot be manipulated by a Government. The final remark was that the international value of a bill on London before the war was largely due to the fact that the Bank of England would always pay in gold on demand.

Nations during the Great War have worked hard to pile up gold resources, but they have worked the printing press much harder in their endeavours to supply what they considered a cheap currency, but which in its effects has been found to be the dearest of all currency. Gold in almost every country has been driven from circulation and paper money issued in lieu thereof, but the weak point in most cases is that the notes issued exceed the amount of metallic currency they have replaced, with the result that prices have been forced up in various countries, that is, the currency has depreciated. It is this increasing volume of currency which

is one of the principal sources of trouble. The most casual student will understand that one cannot increase the volume of a thing without decreasing its value. As an illustration, take the homely case of the humble potato. At one period of the war, potatoes were very scarce and the price ruled high, uncommonly high. Then came the extension of allotments; every one, from the gilded staff officer to the humble road-sweeper, grew potatoes. When the crops matured, potatoes were in excess supply, there were more than enough to go round, consequently their value depreciated, the price came down with a run, and has remained down with the increasing supplies. It is a curious simile, but apply it to the note issues of all countries. In the early days of the war, not many notes were in circulation in enlightened countries, and the value of the currency was relatively high. Then the universal currency providers set the printing press in motion, notes were poured out by the million, and very soon the value of the currency of all the belligerents depreciated.

It has been argued that there is to-day much more work for the currency to do, hence the necessity for the increase. The obvious reply to that is, that any such increase is more than compensated for by an increased velocity of circulation. There may be more work for the currency to do, but the money changes hands so much more quickly than in ordinary times, that it is easy to see the fallacy of the " work of the currency " argument.

It follows that the exchanges of those countries which have issued overwhelming masses of paper currency have been adversely affected; they have reduced the gold value of their currency in terms of the money of other countries. British paper currency is not, of course, so much affected, because under Section 3 of the Currency and Bank Notes Act, 1914, the holder of a currency note, which is for the time being legal tender in the United Kingdom, is entitled to obtain, on demand during office hours at the Bank of England, payment for the note at its face value in gold. However, not one of the belligerent nations has wholly escaped from the evil

effects of the over-issue of paper, and the consequent driving of gold from circulation, and without going into a long explanation of the paper currency question, it is easy to see that when purchasing bills in the country with a depreciating currency for remittance abroad, so much more of the local currency will have to be given for the bill of exchange payable in a foreign country whose currency is not suffering from the same watering of the currency. On the other hand, when selling in a foreign country bills drawn on the country with the depreciated currency, you will get less for your bill than you would had the excess note issues not taken place. In other words, you have to surrender more of your currency because its gold value is less than normal—exchange is against you.

There is no fixed ratio for the exchange of paper currency, any more than there is for the exchange between gold and silver, the mere mention of which is a reminder that we have arrived at the limit to which exchange may be discussed in this Primer. We believe, however, that enough has been said to enable the reader to get a grip on the subject of foreign exchange. We hope that his curiosity has been whetted sufficiently to lead him to take up the study on a more extended scale, but in case he demur at the trouble involved in adding still further to his stock of knowledge, we close with the words: *Par est fortuna labori*—fortune responds to toil.

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Printed by Sir Isaac Pitman & Sons, Ltd., Bath, England
v2—(1741)

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